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Supreme Court of the United States

OCTOBER TERM, 1907

NO. 206

THE OLD DOMINION COPPER MINING AND SMELTING COMPANY, APPELLANT

v.

FREDERICK LEWISOHN AND OTHERS, APPELLEES

BRIEF FOR APPELLANT

STATEMENT OF FACTS

This case is an appeal by writ of certiorari issued to review a decision of the Circuit Court of Appeals for the Second Circuit.

On January 6, 1903, the appellant filed a bill in equity, in the United States Circuit Court for the Southern District of New York, against the appellees as executors of the will of Leonard Lewisohn, late of New York, seeking to rescind a sale to it of certain mining claims and in the alternative for other relief. The respondents in that suit demurred to so much of the bill as sought rescission for want of equity and want of parties and to all the bill for multifariousness.

The bill was founded upon certain transactions by which Leonard Lewisohn and one Albert S. Bigelow of Cohasset, Massachusetts, organized the plaintiff corporation and sold to it certain mining claims in Arizona. Shortly before

this bill was filed a bill identical in terms, except so far as the different positions of the individuals who were defendants made differences necessary, was filed in the Supreme Judicial Court of Massachusetts against Bigelow, to rescind the same sale and in the alternative for other relief. In the latter suit Bigelow filed demurrers identical with those filed in this suit. Bigelow could not be joined in the suit in New York for lack of jurisdiction over his person, and the executors of Lewisohn could not be joined in the Massachusetts suit for lack of jurisdiction there over them. Both bills alleged that the transaction complained of was pursuant to a joint plan and conspiracy by Bigelow and Lewisohn, carried out for their joint benefit. Both suits were necessary unless the plaintiff was to elect to pursue one only of the alleged wrongdoers.

The Massachusetts suit was heard upon demurrer by the Supreme Judicial Court of Massachusetts in December, 1904. The suit in New York was heard upon demurrer on February 20, 1905, and on February 24 the demurrer was sustained (136 F. R. 915). The Circuit Court treated the so-called demurrer to part of the bill as a general demurrer for want of equity and held that the bill stated no cause of action. The bill was then amended so as to make certain allegations more specific, and to the amended bill demurrers identical with those to the original bill were filed, except that the demurrer to the whole bill was also for want of equity.

On June 19, 1905, the Supreme Judicial Court of Massachusetts rendered a decision in the Massachusetts suit against Bigelow, overruling the demurrers. The Court considered carefully the decision of the Circuit Court in the present suit, which had been called to its attention, but declined to follow that decision and held that the bill stated a good cause of action (188 Mass. 315).

The amended bill in the Circuit Court in New York was heard on demurrer in November, 1905. The Court held that the amended bill was in substance the same as the

original bill, and that the orderly course of practice therefore required that the former decision of the Circuit Court be followed and the demurrers sustained. (Record, p. 23.)

From the decision of the Circuit Court an appeal was duly taken to the Circuit Court of Appeals. Upon hearing that Court sustained the demurrers and affirmed the decision of the Circuit Court, briefly dismissing the decision in the Massachusetts suit on the ground of supposed inconsistency with certain decisions of the Circuit Court of Appeals and of the New York Court of Appeals. (Record, p. 31.)

On February 27, 1907, this Court upon the petition of the appellant granted a writ of certiorari to review the decision of the Circuit Court of Appeals.

In November, 1907, the suit in Massachusetts was heard before a single justice of the Supreme Judicial Court, who found all the facts in favor of the plaintiff and entered a decree for the recovery of about two million dollars, including interest.

The material facts set forth in the amended bill of complaint (Record, p. 2) and admitted by the demurrer are as follows:

On and prior to April 30, 1895, there existed a corporation called the Old Dominion Copper Company of Baltimore City, which for convenience is hereinafter called the Baltimore Old Dominion Company. This corporation then owned a copper mine and mining claims in Arizona. It had a capital stock of five hundred thousand dollars par value, divided into twenty-five thousand shares of the par value of twenty dollars each. Of these shares seventeen thousand eight hundred and fifty-seven were then owned by the executors of the will of Michael H. Simpson, late of Boston, and the remainder were owned by William Keyser, of Baltimore. Mr. Keyser also held the legal title to certain mining claims and real estate.

Prior to May 4, 1895, Leonard Lewisohn and Bigelow formed the plan of acquiring all the capital stock of the Baltimore Old Dominion Company and of organizing a

new company and selling to such new company all the mining property of the Baltimore Old Dominion Company at a price which should give them a large profit above the cost to them of the stock of the Baltimore Old Dominion Company, and at the same time of providing the new corporation with working capital and money to use for other purposes by offering to the public for subscription and issuing to subscribers as a part of the same transaction shares of stock in such new corporation. The purpose of the plan was, in short, to buy up the property, or control of the property, in order to sell it at an advance to the new company to be formed by them, taking for themselves the profit of such resale, and at the same time to induce the public to take shares in the new company so as to furnish it with money.

Lewisohn and Bigelow in order to carry out this plan obtained an option at some time prior to May 24, 1895, to purchase from the executors of the will of Michael H. Simpson seventeen thousand eight hundred and fifty-seven shares for seven hundred and fourteen thousand two hundred and eighty-five dollars. For the purpose of providing themselves with the money to buy these shares and carry out their plan, they associated a number of persons with themselves under the name of the Old Dominion Syndicate. The members of the syndicate subscribed to a fund amounting eventually in the aggregate to one million dollars, and undertook to pay in on May 27, 1895, fourteen per cent of their respective subscriptions, and the balance in three equal instalments on July 26, August 25, and September 24 then following, with interest on each deferred instalment at five per cent. The syndicate agreement was in effect that the amount subscribed and paid in should be used for the purpose of acquiring the property or capital stock of the Baltimore Old Dominion Company, and that the subscribers should receive the profit made upon the resale of the property to a new corporation in proportion to the amount of their respective subscriptions (Bill, par. Fourth). The first instalment under the syndi-

cate agreement was paid in on May 27, 1895, and was used in making the first payment under the option. (Par. Fifth.)

About June 13, 1895, Lewisohn and Bigelow, for the purpose of further carrying out their plan, obtained from Keyser an option to purchase the remaining seven thousand one hundred and forty-three shares of stock in the Baltimore Old Dominion Company for two hundred and eighty-five thousand seven hundred and fifteen dollars, and on June 20, 1895, paid the first instalment of the price, using the funds of the syndicate for the purpose. (Par. Sixth.) On the same day Keyser, pursuant to an agreement between him and Lewisohn and Bigelow, and with the consent of the executors of the will of Simpson, conveyed to Lewisohn, without any further payment or consideration, the mining claims and real estate above referred to, and caused Bigelow and Lewisohn to be elected directors and president and treasurer respectively of the Baltimore Old Dominion Company. (Pars. Seventh, Eighth.)

On July 8, 1895, Lewisohn and Bigelow, in order to carry out their plan, procured the incorporation of the plaintiff company under the laws of the State of New Jersey. Seven incorporators, selected and employed by them for the purpose, only one of whom, and he a son of Leonard Lewisohn, had any actual interest, formed the corporation and subscribed for forty shares of stock, all of which were paid for by Lewisohn and Bigelow. The first meeting of the corporation was held on July 9, 1895; by-laws were adopted, the seven incorporators were chosen directors, the capital stock was increased to three million seven hundred and fifty thousand dollars, divided into one hundred and fifty thousand shares of twenty-five dollars each, and officers were chosen from among the seven incorporators. (Pars. Ninth, Tenth.)

On July 11, 1895, a meeting of the directors of the corporation thus formed was held in New York City. Pursuant to instructions from Lewisohn and Bigelow five

of the seven directors successively resigned, and there were chosen successively in their places Bigelow, Leonard Lewisohn, Henry M. Whitney, Joseph G. Ray, and Thomas Nelson; and pursuant to the same instructions the president, vice-president, and treasurer resigned, and Bigelow was chosen president and Thomas Nelson treasurer. Leonard Lewisohn and Bigelow were present at this meeting, and took part in the proceedings after their respective elections as directors. (Par. Eleventh.)

After the above changes had been made, the board of directors of the plaintiff corporation, provided by Lewisohn and Bigelow, consisted of Leonard Lewisohn and Bigelow, Allen W. Evarts, who was the attorney employed by them to carry out their plan, Edward Buffum, a person selected and employed by them for the same purpose, and Henry M. Whitney, Thomas Nelson, and Joseph G. Ray, none of whom were present, and each of whom was a member of the Old Dominion Syndicate and interested in the plan to sell the property of the Baltimore Old Dominion Company to the plaintiff corporation at a price which should yield a large profit. All of these persons had been selected by Lewisohn and Bigelow, and chosen for the purpose of carrying out their plan. (Par. Twelfth.)

On July 11, 1895, the directors of the Baltimore Old Dominion Company, consisting of Bigelow, Lewisohn, and one R. Brent Keyser, who acted as their representative and according to their instructions, authorized all the property of the corporation, except the cash assets, to be offered to the plaintiff corporation for one hundred thousand shares of its stock. (Par. Thirteenth.)

On the same day, at the meeting of the directors of the plaintiff corporation above referred to, and after the changes in the board of directors and in the officers above specified had been made, Bigelow presented to the board of directors so constituted an offer of the Baltimore Old Dominion Company to sell substantially all its property, except cash assets, to the plaintiff for one hundred thou-

sand shares of the capital stock of the par value of twenty-five dollars each, the stock to be issued to the vendor company or its nominee. This offer was in writing, signed by Bigelow as president and by Allen W. Evarts as secretary of the Baltimore Old Dominion Company. Leonard Lewisohn thereupon moved that the offer be accepted, Evarts seconded the motion, and Bigelow and Lewisohn caused it to be unanimously so voted. (Par. Thirteenth.)

Immediately after the above vote was passed Leonard Lewisohn made a proposition to the board of directors of the plaintiff corporation to sell and convey to the plaintiff the mining claims and real estate conveyed by Keyser to him, in return for thirty thousand shares of the plaintiff's capital stock, and accompanied his proposition with a request that the stock be issued to Bigelow and himself. Bigelow and Lewisohn caused the directors unanimously to vote to accept this proposition, and it was so accepted. (Par. Fourteenth.)

Pursuant to their original plan, Lewisohn and Bigelow, about July 18, 1895, in order to furnish the plaintiff with money for working capital, and for other purposes, caused the twenty thousand shares of the plaintiff's stock remaining undisposed of to be offered by the corporation to the public for subscription at its par value. All this stock was so subscribed and taken. The subscribers were entirely ignorant of the profit made by Lewisohn and Bigelow from the sale of the mining claims and real estate to the plaintiff. (Par. Fifteenth.)

On or before July 8, full payment was made to the executors of the will of Michael H. Simpson and to William Keyser for all the stock of the Baltimore Old Dominion Company. These payments, amounting in the aggregate to one million dollars, were from the funds contributed to the Old Dominion Syndicate or in part from such funds and in part from money provided by Lewisohn which was afterwards repaid to him from the funds of the syndicate. (Par. Sixteenth.)

Possession of the property of the Baltimore Old Do-

minion Company sold to the plaintiff was given on July 12, 1895, and subsequently that property and the real estate and mining claims originally standing in the name of Keyser and conveyed by him to Lewisohn were duly conveyed to the plaintiff. On September 18, 1895, Lewisohn and Bigelow caused all the stock of the plaintiff corporation to be issued — one hundred thousand shares to the nominee of the Baltimore Old Dominion Company for the property of that company, thirty thousand shares to themselves for the real estate and mining claims, and twenty thousand shares to the cash subscribers. (Par. Sixteenth.)

The property conveyed to the plaintiff by the Baltimore Old Dominion Company was at the time of conveyance fairly worth not more than one million dollars. The real estate and mining claims conveyed to the plaintiff by Lewisohn were fairly worth not more than five thousand dollars. Bigelow and Lewisohn acquired the stock of the Baltimore Old Dominion Company and the real estate and mining claims, knowing that the several properties were not then fairly worth more than the amounts above specified respectively, and with intent to sell the properties for much more than the cost. They made no disclosure to the plaintiff corporation or to any of the persons who subscribed for stock or joined the Old Dominion Syndicate as to the value, and because of their control over the plaintiff corporation no inquiry was made by it or in its behalf. (Par. Seventeenth.)

By the foregoing transactions Bigelow and Lewisohn acquired for one million dollars all the stock of the Baltimore Old Dominion Company, and acquired without the payment of any additional consideration the real estate and mining claims. They organized the plaintiff corporation sold to it, and controlling it absolutely caused it to buy the property of the Baltimore Old Dominion Company for one hundred thousand shares of stock having a par value of two and a half million dollars, sold to it the real estate and mining claims for thirty thousand shares having a par value of seven hundred and fifty thousand dollars, and had

the plaintiff issue to the public for cash twenty thousand shares having a par value of five hundred thousand dollars. (Par. Eighteenth.)

Bigelow and Lewisohn divided eighty thousand shares out of the one hundred thousand among the members of the syndicate, retaining the other twenty thousand ostensibly for their expenses, which in fact did not exceed six thousand dollars. They divided between themselves the thirty thousand shares received for the real estate and mining claims. (Par. Nineteenth.)

All of the foregoing transactions were pursuant to a preconceived scheme on the part of Bigelow and Lewisohn. Before they acquired the stock of the Baltimore Old Dominion Company they had formed a plan to organize a corporation to take over the property at a large advance on the cost, and at the same time issue stock to the public for working capital. They formed the syndicate in order to provide money with which to acquire the stock and through the stock the property. In order to carry out their original plan they organized the plaintiff corporation, put themselves in absolute control, and caused it to buy from the Baltimore Old Dominion Company, also controlled by them, and from Lewisohn individually, the properties in question; and as a part of the same plan and of the same transaction they had shares of the plaintiff's stock offered to the public for subscription and issued to the subscribers in order to furnish a working capital. (Par. Twenty-first.)

Bigelow remained president and chief executive of the plaintiff corporation continuously from its organization until April 4, 1902. Throughout that period the board of directors was made up of persons selected by Bigelow and Lewisohn, a large majority of whom were personal friends of theirs and had been interested in the transactions set forth. No disclosure was ever made as to these transactions, and until after April 4, 1902, when a change of management took place, the plaintiff had no knowledge

of the facts or that Bigelow and Lewisohn had taken a profit. (Par. Twenty-second.)

The real estate and mining claims have since the conveyance to the plaintiff remained undeveloped, and are now in substantially the same condition as at the time of the conveyance. (Par. Twenty-third.)

Lewisohn died March 5, 1902, a resident of New York, and the defendants are the executors of his will there proved and are all citizens of New York. (Par. Twenty-fourth.)

On September 12, 1902, as a result of investigations, the plaintiff asserted a right to rescind the sale and conveyance to it of the real estate and mining claims and offered to make such rescission. The defendants denied any right to rescission or recovery. (Par. Twenty-fifth.)

The plaintiff desires to make such rescission, and by its bill offers to convey the real estate and mining claims to such person or persons as the Court may direct. Bigelow is a citizen of Massachusetts and not within the jurisdiction of the Court. The plaintiff does not in this suit seek any relief as to the sale to it of the property of the Baltimore Old Dominion Company, as to which a separate suit is pending. (Par. Twenty-sixth.)

The prayer of the bill is (Record, p. 17):

1. For a rescission of the sale and conveyance.
2. A return of the thirty thousand shares given as consideration.
3. In the alternative, in case the Court refuses to grant rescission, an ascertainment by the Court and recovery of damages suffered by the plaintiff.
4. For general relief.

To this bill of complaint the defendant filed two demurrers:

First. To the whole bill for want of equity and for multifariousness in joining distinct and inconsistent causes of action and prayers of relief. (Record, p. 21.)

Second. To so much of the bill as seeks rescission for want of equity and for absence of Bigelow as a party. (Record, p. 22.)

The Circuit Court sustained the demurrer to the original bill for want of equity and overruled it as to multifariousness (136 Fed. R. 915). The demurrer to the amended bill for want of equity was sustained and the bill ordered dismissed (Record, p. 23). From this decision the plaintiff appealed. The Circuit Court of Appeals affirmed the decision of the Court below. (Record, p. 30.)

Summary

Shortly stated, the case set out in the bill is as follows:

Leonard Lewisohn and Bigelow formed a plan to acquire the mining property of the Baltimore Old Dominion Company, to resell it at a profit to a corporation to be formed by them for the purpose of purchasing, and to furnish the new corporation with working capital by having it issue part of its stock to the public.

In pursuance of this plan they acquired options on all the stock of the Baltimore Company, formed a syndicate to raise the one million dollars necessary to carry out the options, and did purchase with the money so raised all the stock. The members of the syndicate by the terms of the syndicate agreement were to share proportionately to their contributions in the profit (Rec. p. 4). William Keyser, owner of a part of the stock, who had given an option on his shares, upon completion of the purchase in addition to transferring his stock, conveyed to Lewisohn for the joint benefit of Lewisohn and Bigelow, certain mining claims now in question. The only consideration paid for this conveyance and transfer was the option price of the stock.

Lewisohn and Bigelow then organized the plaintiff corporation. The organization was effected by seven persons selected for the purpose who subscribed for forty shares, all of which were paid for by Lewisohn and Bigelow. On July 11, 1895, the authorized capital was increased to one hundred and fifty thousand shares of twenty-five dollars each. Bigelow was chosen president, and the board of directors was reorganized so as to consist of Bigelow, Lewisohn, their attorney Evarts, an employee Buffam, and three members of the syndicate selected by them. After the changes in the board of directors Bigelow, Lewisohn, Evarts, and Buffam, being the only directors present, voted to accept an offer made by Bigelow as president of the Baltimore Company to sell all its property,

except cash assets, for one hundred thousand shares of the plaintiff's capital stock and an offer of Lewisohn to sell the mining claims for thirty thousand shares.

One week later the directors offered the remaining twenty thousand shares (the forty shares already subscribed for being disregarded) to the public; those shares were all subscribed for at par. The property was conveyed, and on September 18, 1895, all the capital stock was issued: one hundred thousand shares to a nominee of the Baltimore Company, in payment for the mining property, of which shares the syndicate received eighty thousand and Bigelow and Lewisohn appropriated the remainder; thirty thousand shares to Bigelow and Lewisohn for the mining claims; twenty thousand shares to the subscribers.

All of the acts set forth were done by Bigelow and Lewisohn as part of their original plan and in order to carry it out. The issue of shares to the public for working capital and the issue for the property purchased constituted in fact parts of a single transaction. None of the other syndicate members and none of the cash subscribers knew of the property taken by Bigelow and Lewisohn on the sale to the corporation of the mining claims, and the facts remained undisclosed until in 1902 Bigelow and Lewisohn ceased to control the corporation.

The prayer of the bill is for a rescission of the sale of the mining claims and recovery of the consideration, or in the alternative for an accounting or for recovery of the damage suffered by the corporation.

The real question presented by the demurrer for want of equity is whether under the circumstances set forth in the bill Bigelow and Lewisohn were liable to the corporation as promoters for the secret profit made by them upon the sale of the mining claims. It has not been seriously denied that they were in every legal sense promoters of the plaintiff corporation. But the respondents have contended that the facts show no case of a promoter's liability, and the Circuit Court of Appeals so held, apparently on the ground that when the vote to accept the offer made the

corporation was passed the only persons interested were the promoters themselves, and that it was immaterial whether or not other persons were immediately to become members of the corporation at the promoters' invitation and as a part of their plan for completing the organization of the corporation, or became interested before the sale was completed and the stock transferred. This view it is believed is wholly at variance both on principle and authority with the law regulating the duties and liabilities of promoters.

SPECIFICATION OF ERRORS

First. The Court erred in holding that the bill was without equity.

Second. The Court erred in not holding that the sale complained of was voidable by the corporation.

Third. The Court erred in holding that the sale was made valid by acquiescence of all persons at the time constituting the corporation.

Fourth. The Court erred in not holding that the plaintiff was entitled to a rescission or in the alternative to an account of profits.

ARGUMENT

FIRST

THE SALE WAS MADE BY PROMOTERS TO A CORPORATION ORGANIZED FOR THE PURPOSE AND EXCLUSIVELY CONTROLLED AND REPRESENTED BY THEM.

Lewisohn made the sale now in question direct to the plaintiff corporation. He had acquired title to the mining claims for the benefit of himself and Bigelow (Bill, par. Eighth, Rec. p. 6); he offered to convey them to the corporation for thirty thousand shares of its stock; the offer was accepted, conveyance was thereafter made by him to the corporation, and the shares were issued as requested to him and Bigelow jointly.

Lewisohn and Bigelow stood in the relation of promoters to the plaintiff corporation. It is not necessary to consider precisely what constitutes a promoter, for according to any and all definitions the relation of promoter existed here. Lewisohn and Bigelow conceived the plan of organizing the Old Dominion Copper Mining and Smelting Company (Bill, par. Third, Rec. p. 3); they caused it to be organized and selected the original incorporators and paid for the original subscriptions of these incorporators to the capital stock (Bill, par. Ninth, Rec. p. 6); they selected the first board of directors, by whom the purchase was made, and the other officers (Bill, par. Eleventh, Rec. p. 7); they and they alone through their agents did all that brought the corporation into existence; they caused the stock not otherwise disposed of to be offered for public subscription (Bill, par. Fifteenth, Rec. p. 9); and all of these acts were done as part of a preconceived scheme, of which making the purchase of the mining claims was a part. (Bill, par. Twenty-first, Rec. p. 13.)

These facts are similar to those shown in *Dickerman* v. *Northern Trust Company*, 176 U. S. 181. In that case (p. 203) this Court fully approved the following definition of a promoter given by Mr. Cook:

> "A promoter is a person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions and sets in motion the machinery which leads to the formation of the corporation itself." Cook on Stockholders, sec. 651.

The plaintiff corporation was organized by Bigelow and Lewisohn for the express purpose of purchasing the property in order to carry out the original plan. At the time the sale was made and for a long time after the corporation was in the absolute control of the promoters. They provided it with a board of directors consisting of themselves, their attorney, and their employees, and three other persons friendly to them who were absent when the transaction was carried out. The corporation was represented in the transaction by the four directors present, the two promoters and their two agents who acted, and were selected in order that they might act, according to instructions. (Bill, par. Twenty-first, Rec. p. 14.)

The sale to rescind which this suit is brought was thus made to the plaintiff corporation at a time when it had no independent existence or representation; the promoters who sold acted as the agents and representatives, and as the only agents and representatives, of the purchaser. It is in respect to the sale so made that relief is sought.

SECOND

A CORPORATION IS ENTITLED TO RELIEF AGAINST A SALE MADE TO IT BY PROMOTERS WHO THEMSELVES CONTROL THE CORPORATION UNLESS ALL PERSONS ENTITLED TO OBJECT ACQUIESCE.

I

The rule is universal that if a vendor stands in a fiduciary relation to his vendee the sale is voidable, unless independently acquiesced in by the latter with full knowledge of all material facts.

It is a general rule of universal application in equity that one who stands towards another in a fiduciary relation shall not deal with his beneficiary unless he puts the latter in every respect on an equality by seeing that he is independently represented and has all the relevant information as to the proposed transaction which the trustee has. If in any transaction a trustee, including in the term all persons occupying a fiduciary relation, has in effect dealt with himself, has acted in behalf of his beneficiary when the trustee himself had an adverse personal interest, or by the use of his position as trustee has made a profit, even though not made at the expense of the trust estate, the beneficiary may avoid the transaction and may recover the profit. It is immaterial that the beneficiary has not been cheated; the transaction may even have been advantageous for him; he can none the less avoid it.

Wardell v. *Railroad Co.*, 103 U. S. 651, 658.
Thomas v. *Peoria & R. I. R. Co.*, 36 F. R. 808.
Tyrrell v. *Bank of London*, 10 H. L. C. 26.
Aberdeen Railway Co. v. *Blaikie*, 1 McQueen, 461.

II

A promoter stands in a fiduciary relation to the corporation he promotes, and is subject to this rule.

The duty of a promoter to his corporation was described by this Court, though the case did not call for an application of the principle, in *Dickerman* v. *Northern Trust Company,* 176 U. S. 181. The Court there said:

> "He is treated as standing in a confidential relation to the proposed company, and is bound to the exercise of the utmost good faith. Lloyd, Corporate Liability, 18; *Densmore Oil Co.* v. *Densmore,* 64 Penn. St. 43; *Bosher* v. *Land Co.,* 89 Virginia, 455. The promoter is the agent of the corporation and subject to the disabilities of an ordinary agent. His acts are scrutinized carefully, and he is precluded from taking a secret advantage of the other stockholders." P. 204.

Occupying a fiduciary position, promoters are held to the same strict accountability in dealings with the corporation to which they owe their duty as other trustees. If they make a contract with the corporation, the contract may be invalidated unless it appears that the corporation acted independently and with full knowledge. If they take a secret profit in their dealings with the corporation, they may be required to return that profit, just as a director selling to his corporation may be compelled to return his profit, or the sale may be avoided.

In *Yeiser* v. *U. S. Board & Paper Co.,* 107 F. R. 340, certain individuals secured an option on a paper mill; they organized a corporation and sold the property to it at an advance of twenty-five thousand dollars, paying for a part of the stock that they subscribed for with the purchase money received from the corporation. The Circuit Court of Appeals held that the profit was illegal and that the corporation could recover the profit by annulling the

title of the promoters to the amount of stock paid for with the money representing the profit.

In *Hayward* v. *Leeson*, 176 Mass. 310, promoters secured options on land; they then organized a dummy corporation which took over the options and in turn sold them to the East Tennessee Land Company, taking stock in the latter in payment. The promoters by this sale realized and took to themselves a profit of seven hundred thousand dollars in stock of the East Tennessee Land Company. The latter corporation having failed, the Court held that its receiver could recover in suits brought against two of the promoters for the profits made by them.

In *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315, upon a bill against Bigelow, setting forth the same facts as the present bill, the Court held on demurrer that the defendant was liable. Mr. Justice Loring said:

> "It was settled by the recent case of *Hayward* v. *Leeson*, 176 Mass. 310, that a promoter of a corporation stands in a fiduciary relation to the corporation of which he is a promoter." 188 Mass. 320.

In *Central Trust Co.* v. *East Tennessee Land Co.*, 116 F. R. 743, the soundness of the decision in *Hayward* v. *Leeson* was called in question, and the decision was explicitly approved by the Circuit Court of Appeals.

In *Yale Gas Stove Co.* v. *Wilcox*, 64 Conn. 101, a promoter organized a corporation to acquire a patent. He caused the corporation to buy the patent at a price much higher than that at which the owner was in fact willing to sell and took a large profit to himself from the excess. The patent was a valuable one and the corporation did not desire to rescind the sale, but it sued to recover the profit and the suit was sustained.

In other cases recovery has been allowed under like circumstances:

Chandler v. *Bacon*, 30 F. R. 538.
Burbank v. *Dennis*, 101 Cal. 90.

The Telegraph v. *Loetscher*, 127 Iowa, 383.
Hinckley v. *Sac Oil & Pipe Line Co.*, 132 Iowa, 396.
Camden Land Co. v. *Lewis*, 101 Me. 78.
Fred Macey Co. v. *Macey*, 143 Mich. 138.
South Joplin Land Co. v. *Case*, 104 Mo. 572.
Exter v. *Sawyer*, 146 Mo. 302.
Woodbury Heights Land Co. v. *Loudenslager*, 55 N. J. Eq. 78; 56 N. J. Eq. 411; 58 N. J. Eq. 556.
First Avenue Land Co. v. *Hildebrand*, 103 Wis. 530.
Hebgen v. *Koeffler*, 97 Wis. 313.
Hitchcock v. *Hustace*, 14 Hawaii, 232.

In England the rule is equally well established.

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, a syndicate formed by Erlanger purchased the lease of a phosphate island, formed a corporation to take over the lease, caused the directors selected by the syndicate to vote to purchase the lease at a large profit from a dummy who held it for the syndicate and at the same time to issue shares to subscribers. The company was not prosperous, and the profit made by the syndicate becoming known, suit was brought to rescind. It was held that the promoters had violated their duty in selling to the corporation without furnishing it an independent body of directors and making a full disclosure, and that the sale could be rescinded.

In *Gluckstein* v. *Barnes* (1900), A. C. 240, promoters purchased the property of a corporation that was in liquidation. They organized a corporation to take over their purchase at a considerable profit, which was fully disclosed. Before completing the transaction they secured for themselves a large additional profit by buying up at a discount securities of the liquidating corporation receivable in payment of the price they were to pay the liquidator. This profit was not disclosed. The House of Lords held that the promoters, by reason of their fiduciary position, were liable to the corporation they had organized for the amount of this profit.

III

The liability of the promoter exists independently of any misrepresentation, of the issue of a prospectus, or of the particular method in which the transaction is carried out.

The liability of a promoter arises from the fiduciary position which he occupies. Relief is granted for breach of the duty imposed by that position. The duty of one acting in a fiduciary capacity is to engage in no transaction in which his interest and that of his beneficiary may conflict without putting the beneficiary in a position to act independently and with knowledge of all material facts known to the trustee. If the trustee would deal with the beneficiary or in a matter in which the interests of the beneficiary may be affected, and himself has an adverse interest, he acts at his peril unless he first sees to it that his beneficiary is independently represented and has the benefit of a full disclosure.

The foundation of the liability is not the necessity of redressing actual fraud, but of preventing the possibility of wrongdoing. This Court said in *Marsh* v. *Whitmore*, 21 Wall. 178, 183, 184:

> "The character of vendor and that of purchaser cannot be held by the same person. They impose different obligations. Their union in the same person would at once raise a conflict between interest and duty, and, constituted as humanity is, in the majority of cases duty would be overborne in the struggle. The law, therefore, wisely prohibits a party selling on another's account from becoming a buyer on his own at the sale, and will always condemn transactions of that character whenever their enforcement is attempted."

Relief will be granted, even though the transaction was perfectly fair, if there was not independent representation.

Gilman C. & S. R. R. Co. v. *Kelly*, 77 Ill. 426, 435.
Dutton v. *Willner*, 52 N. Y. 312.

It is perfectly immaterial, as far as the existence of the promoter's liability is concerned, whether there is actual misrepresentation or not. Misrepresentation is merely an aggravation of the offence; there is a breach of duty as much in case of non-disclosure as in case of misstatement. This rule applies as much to a promoter as to any other person in a fiduciary position. To convict the promoter of a breach of duty justifying relief, it is no more necessary to show misrepresentation than in a proceeding for relief against an express trustee or an agent.

In the Erlanger case Lord Justice James in the Court of Appeals said:

"A promoter is, according to my view of the case, in a fiduciary relation to the company which he promotes or causes to come into existence. If that promoter has a property which he desires to sell to the company, it is quite open to him to do so; but upon him, as upon any other person in a fiduciary position, it is incumbent to make full and fair disclosure of his interest and position with respect to that property. I can see no difference in this respect between a promoter and a trustee, steward or agent." 5 Ch. D. 118.

In *Gluckstein* v. *Barnes*, (1900) A. C. 240, Lord Robertson said:

"To my thinking, the central fact in the history is, that while the object of the syndicate was to make a profit out of the resale of Olympia, it was an essential part of the enterprise, as originally designed and as actually carried out, that the same individuals who sold as syndicate should buy as directors." P. 256.

The liability does not rest upon deception or upon the sale being at too high a price. Mr. Justice Loring of the Supreme Judicial Court of Massachusetts, in dealing with the same facts now before the Court in the bill brought against Bigelow, speaking of the rights and liabilities of the promoters as to the property sold, said:

"Being the absolute owners of it, the defendant and Lewisohn could do with that property as they pleased, — let it lie idle, work it, or sell it, as they thought best, and if they determined to sell

it they could sell it to any one they might choose. If they chose to sell it to a stranger they could make the sale at arm's length, they could ask any price they pleased, and were under no legal obligation to state what it had cost them. On the other hand, if they elected to make a sale of it to one standing to them in a fiduciary relation, they were under an obligation to make a full disclosure to the beneficiary of all the facts known to them material to the property and the purchase, or see to it that the fiduciary had adequate independent advice. That is an obligation resting upon every fiduciary who makes a sale of his own property to his beneficiary, no matter whether it is a case of trustee and *cestui que trust*, guardian and ward, solicitor and client, or promoter of a corporation and the corporation itself." 188 Mass. 322.

As the foundation of the liability is the duty imposed by the fiduciary relation, it is clear that misrepresentation cannot be an essential part of the cause of action, and equally clear that the issue of a prospectus is immaterial. A prospectus is merely a public invitation or representation. If the prospectus is false, the effect is the same as if the persons responsible for its publication had made the same statements privately to each individual who has acted on the faith of the prospectus. A false prospectus issued by promoters may furnish convenient evidence of their breach of duty, if accompanied by evidence that no disclosure of facts was made except by the prospectus. But the mere issue of a false prospectus is not in itself proof of a breach of fiduciary duty or an essential part of such proof.

Misrepresentation, whether by means of a prospectus or otherwise, gives an individual cause of action at law to the person who has acted upon it to his detriment; breach of the fiduciary duty owing by a promoter to the corporation he represents gives no individual right of action to any single member of the corporation, but entitles the corporation, as representing its members collectively, to relief.

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, the form and candor of the prospectus were

discussed as bearing on the completeness of the disclosure made; but the issue of the prospectus was not the ground of recovery. All the judges in all the courts were unanimous in holding that the corporation was entitled to relief for failure of the promoters to disclose the profit they were making in selling property to the corporation, not for misrepresentation. Lord Blackburn carefully pointed out that this result was not based upon any misrepresentation or the issue of a prospectus, as to the effect of which he said:

"If individuals were deceived by misrepresentations a case might exist entitling such individuals to be personally relieved against the consequences of such misrepresentations, but the company would not have any title to be relieved on account of such misrepresentations to individuals, especially if the misrepresentations were made by those who at the time represented the company." P. 1264.

And later in his opinion he said:

"A great deal was said about the prospectus based on these letters being fraudulent. If this had been made out it would not have formed a substantive ground for relief to the company, but it would, I think, have been very material evidence that the board of directors who adopted and issued the fraudulent prospectus were under the undue influence of those who framed it." P. 1274.

In *Hayward* v. *Leeson*, 176 Mass. 310, there was a prospectus issued containing false statements, and in the case of *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315, counsel for the defendant sought to distinguish the earlier case on that ground. The Court by Mr. Justice Loring, who wrote the opinion of the Court in both cases, repudiated such a distinction, and explained that the prospectus had nothing to do with the cause of action, saying:

"The defendant has sought in the first place to distinguish the case at bar from *Hayward* v. *Leeson*, 176 Mass. 310, on the ground that in the prospectus in that case there was the false statement that the capital stock represented actual value, without inflation,

while a substantial part of it had been issued to the defendants and their associates for nominal services. But that fact was not spoken of in the opinion as the ground of the decision. The opinion went on the broad ground mentioned above. This false representation was spoken of in connection with a contention on the part of those defendants that they were not liable because of a finding made by the Superior Court that the defendants did not conceal the transaction from the knowledge of future stockholders." 188 Mass. 322.

Counsel for the appellees in the Circuit Court of Appeals laid it down as the rule that a promoter's liability could exist only in the following cases:

> "(1) such promoter must have purchased the property with the funds of the company;
>
> (2) or having previously purchased the property with his own funds reimburse himself from the funds of the company; or,
>
> (3) by the issuance of a prospectus containing inducements, false representations or concealments which tends to create a false impression and which amounts to misrepresentation."

Such a classification is purely empiric. Even if comprehensive it would be of no value because based merely on the presence of certain facts irrespective of the effect given those facts. No authority cited for the appellees sustained the proposition that one of the sets of facts enumerated was essential to create a promoter's liability. That actual misrepresentation or the issue of a prospectus is not essential has been shown both on principle and on the American and English authorities. The other two possible grounds of liability refer only to the precise method by which the secret profit is secured. By the first formula it is apparently meant that property resold by a promoter must have originally been purchased by him with the funds of the corporation in order to entitle the corporation to relief. Such a statement is contrary to all authority. No such state of facts existed in *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, or in

Gluckstein v. *Barnes*, (1900) A. C. 240, or in any of the leading cases. Reimbursement from the funds of the corporation appears to mean nothing more than a sale to the corporation. If by using the word " funds " it is intended to limit the transaction to a cash sale the authorities are otherwise. In both the English cases last referred to the profit of the promoters was made in part from stock received upon a sale to the corporation; so in the two Massachusetts cases and in *Yeiser* v. *U. S. Board & Paper Co.*, 107 F. R. 340, the sale was partly or wholly for stock. To assert that the application of the principle giving relief for breach of a fiduciary duty is dependent on the form in which the unfaithful trustee receives his booty is to abandon discussion of the question from a juridical standpoint.

None of the many authorities referred to by the appellees as upholding their contention either in the form above quoted or as to the necessity of misrepresentation by prospectus or otherwise, support the proposition.

In *Salomon* v. *Salomon*, (1897) A. C. 22, " the one man company case," the sole owner of a business incorporated it, issuing all the stock to himself except shares issued to his nominees to qualify them as directors. There was no liability because no person except himself was interested in the transaction. The distinction between such a case and the Erlanger case or *Hayward* v. *Leeson* is not the presence or absence of a prospectus, but absence of any violation of fiduciary duty because of the acquiescence of all to whom any duty could be due.

In *Tompkins* v. *Sperry*, 96 Md. 560, the promoters purchased all the property transferred to the corporation and transferred it in exchange for all the stock. Some part of the stock so received was afterwards sold by the promoters to others, but in such sales only the individual rights of the respective purchasers were involved. The Court distinguished the case from *Gluckstein* v. *Barnes* and *Erlanger* v. *New Sombrero Phosphate Co.*, on the ground that in those cases there was a secret profit taken:

"The promoters had a secret profit in the land which the corporation was formed to take over, and they issued a prospectus which did not disclose that fact, and thereby induced other persons to subscribe to the stock." P. 581.

The real distinction between such a case as *Tompkins* v. *Sperry* and the cases from which the Court distinguished it lies not in the absence of a prospectus, as to the presence or absence of which the report of *Tompkins* v. *Sperry* is silent, but in the presence or absence of persons having an interest in the corporation who do not knowingly acquiesce in the transaction; and it is this distinction on which the Court in *Tompkins* v. *Sperry* relied.

The fact that the right of action for a breach of fiduciary duty rests in the corporation illustrates the same principle. For deceit caused by the issue of a false prospectus each individual who is deceived has, as pointed out by Lord Blackburn, his remedy against the persons responsible. It is immaterial whether the plaintiff in such a case is an original subscriber or a purchaser of stock, if his act is the natural and intended result of issuing the prospectus.

On the other hand, for a breach of the fiduciary duty of a director or promoter the corporation only is entitled to maintain an action. The fiduciary duty of promoters and directors to their corporation is of course in the last analysis a duty to the individuals who collectively form the corporation. But it is the corporation with whom the obnoxious transaction is made. The ground of complaint is not that the promoters have by false representations induced the individuals to go into an enterprise, but that they have caused the corporation to make a contract, giving the promoters a secret profit, in which those individuals have not acquiesced.

THIRD

SUCH ACQUIESCENCE MUST INCLUDE ALL PERSONS WHO ARE OR BECOME INTERESTED IN THE ENTERPRISE AS ASSOCIATES OF THE PROMOTERS.

I

The duty of the promoters extends to all persons whom they bring in as original subscribers for stock, whether before or after the transaction complained of.

Any transaction between a trustee and his *cestui que trust* may be validated if the latter with full knowledge acquiesces in or ratifies the transaction. A director may sell to his corporation if the latter is at the time independently represented and receives a full disclosure of all relevant facts, or if subsequently the corporate body having such knowledge approves the sale. The protection of the fiduciary relation does not require that a beneficiary who is *sui juris* and put in a position of equality as to information should be disabled from dealing with his trustee.

The same principle applies in the case of a promoter. His duty to the corporation prevents him from dealing with it unless he has entitled himself to do so by fully disclosing all material facts and by giving the corporation an independent representative; if the promoter has failed to do this the transaction may yet be made valid by the ratification or approval of all persons who were interested. But in order that there may be such ratification or validation the transaction must be acquiesced in or approved by all the persons who constitute the corporate body entitled to object. The fact that individual members have approved or acquiesced cannot affect the rights of the corporation, which are the collective rights of all of its members. An innocent shareholder cannot be bound by the

approval of a majority, any more than an *ultra vires* act can be ratified except by unanimous approval.

1 Morawetz on Private Corporations, 2d ed., sec. 294.

Acquiescence makes valid a transaction otherwise voidable because it is the approval or ratification of those persons comprising the corporate body to which the fiduciary duty was owed. The persons who must acquiesce are those to whom there is such a duty; the persons who suffer from a breach of the duty.

The fiduciary relation of a promoter extends to all persons who join in starting the enterprise which he sets on foot. Persons who subscribe for stock of the corporation, at least where such stock is to be issued to subscribers as part of the plan for launching the enterprise, are clearly within this category. Where a promoter having created the skeleton of a corporation causes it to make a contract with him, that contract becomes binding upon the body of subscribers when by the issue of shares to them they become stockholders. If without disclosure to such subscribers the promoter has caused the skeleton corporation to make a contract giving to him a profit, each subscriber is injured by the lack of good faith. Each subscriber as to his interest in the corporation becomes bound by that contract. These subscribers are the persons who in their collective capacity become bound by the contract as soon as they become shareholders; if their becoming shareholders is a part of the promoter's original plan, then in making the contract he knowingly and intentionally imposes the contract on them at a time when in doing so he is in control of and representing the inchoate corporation to which they by their subscriptions for stock are to give vitality.

1 Morawetz on Private Corporations, 2d ed., sec. 292.

The courts fully recognize the nature and extent in this respect of a promoter's duty. It is correctly and conveniently described as a fiduciary duty to the corpora-

tion, because the corporation represents the collective rights of its members; but the duty is universally held to include all those persons who join in the enterprise by becoming original stockholders.

In *Dickerman* v. *Northern Trust Company*, 176 U. S. 181, this Court said of a promoter:

"He is precluded from taking a secret advantage of the other stockholders."

In *Yeiser* v. *U. S. Board & Paper Company*, 107 F. R. 340, 348, the Court said:

"In this country the courts have accepted the essential principle laid down in the English cases, and hold, with scarcely any variation to the doctrine, that the promoter of a company stands in the relation of a trustee to it and those who become subscribers to its stock, so long as he retains the power of control over it."

In *Chandler* v. *Bacon*, 30 F. R. 538, 540, Judge Colt stated as the basis of recovery from promoters who on a sale to the company by a third person had by agreement received a number of shares:

"The law forbids them, from their position, to secretly derive any benefit over other stockholders, and makes them accountable to the company for any profit so derived."

In *Hayward* v. *Leeson*, 176 Mass. 310, 320, the Court said:

"The persons to whom the promoters owe the duty which they owe by reason of their fiduciary relation are the persons who put their money into the enterprise at the invitation of the promoters, that is to say, the future stockholders."

In *South Joplin Land Co.* v. *Case*, 104 Mo. 572, 579, the Court said:

"And persons who subscribe for stock have a right to do so upon the assumption that the promoters are using their knowledge, skill and ability for the benefit of the company."

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 A. C. 1218, the company was formed and registered and the

contract of sale by the vendors to it entered into before the subscriptions for shares were solicited or obtained. None of the judges before whom the case came doubted that the fiduciary duty existed and was violated by failure to disclose the facts to the subscribers.

In *Gluckstein* v. *Barnes*, (1900) A. C. 240, 257, Lord Robertson, referring to the promoters, said:

"The people for whom these gentlemen were bound to act were their coming constituents, the persons out of whose money they proposed to make their gain."

In *Re Leeds & Hanley Theatres*, (1902) 2 Ch. 809, Lord Justice Williams, speaking of a promoter, said:

"I do not mean that the Finance Company stood in a fiduciary relation to these directors and these seven signatories to the memorandum of association, but to the future allottees of shares in the Theatre Company."

And again:

"I do not think it matters whether they made a disclosure to the directors who were their nominees or whether they did not, for as I have already pointed out, among their *cestuis que trust* were the future allottees of shares."

It was pointed out in like manner, in the earlier case of *Re British Seamless Paper Box Co.*, L. R. 17 Ch. D. 467, that the persons who actually furnished the bone and sinew of the corporation, although they might not become members until after the transaction complained of, were the persons to whom the promoters owed their duty. Sir George Jessel said:

"You can defraud future allottees as well as present allottees." P. 472.

And Lord Justice Cotton said the principle was:

"that the directors stand in a fiduciary position to the whole company, that is, not only to the existing members, but to all whom they intend to bring in." P. 479.

Any device by which a promoter gains an advantage over those who associate themselves with him in his enterprise is a violation of duty, and unless such person with full knowledge acquiesces the transaction is voidable. The decisive point is not whether the person becomes a member of the corporation at one time or another, before or after the transaction complained of. The test is whether he joins under such conditions and at such a time that the promoter is in reality acting for him, and this depends on whether he is one of the persons whose co-operation is expected and required as a part of the promoter's plan. One who joins the corporation as an original subscriber satisfies this test. It is these subscribers who in effect give reality to the transaction; it is they from whose money the promoter expects to make his profit; until they join the corporation and make up an actual corporate body, the enterprise is incomplete. Every such subscriber is entitled to rely upon the fiduciary relation with the promoter, and the assent of every such subscriber is necessary to validate a transaction otherwise voidable.

II

It is not enough that all persons who have formally joined the corporation at the time of the transaction assent if others are in fact interested and join as part of the original plan.

The fiduciary relation of a promoter is not confined to those persons who at a particular time have become members of the corporation. The courts recognize his obligation to future stockholders who associate themselves with him. He may "defraud future allottees." The acquiescence in any transaction with the corporation of those persons who have at the time become members of the corporation is not therefore the acquiescence of all persons to whom the obligation extends. Only by the acquiescence of all towards whom the fiduciary relation exists can the act of

the promoter in dealing with himself as their agent be validated. If when a transaction takes place there are other persons interested, or if it is then contemplated as part of the scheme that others shall become interested, there can be no complete acquiescence such as to make the transaction binding. A part of the beneficiaries cannot condone a breach of trust. A part of the persons interested cannot bind the rest to an affirmance of a violation of fiduciary duty. Even though in form the persons assenting constitute for the time being the whole corporate body, their assent is unavailing if in substance there are, as part of the enterprise, others equally entitled to protection. Any other rule would effectually prevent relief in most cases, because in the usual course the transaction complained of takes place before there are any stockholders except the promoters themselves.

In *Dickerman* v. *Northern Trust Co.*, 176 U. S. 181, the facts in which appear more fully in the case before the Circuit Court of Appeals, 80 F. R. 450, promoters obtained options on certain manufacturing plants, all of which were taken in the name of or turned over to Stein. A corporation was organized by the promoters, and Stein offered to the corporation the property under option, together with a working capital of two hundred thousand dollars, in exchange for all its stock and an issue of bonds. This proposition was accepted and the stock was transferred by Stein to, or by his orders issued direct to, the owners of the plants. This Court unequivocally declared the transaction a violation of the fiduciary duty of the promoters, but as the case before it was a proceeding to foreclose a mortgage given to secure bonds which were in any event enforceable in the hands of the holders, there was no relief to be granted.

Yeiser v. *U. S. Board & Paper Co.*, 107 F. R. 340, was a precisely similar case. The promoters secured an option, then organized a corporation which accepted their offer to sell the property at an advance. After this subscriptions for stock were taken and eventually the transaction was con-

summated as planned. Here it was the duty to stockholders becoming such after the contract complained of was made that gave a right to relief, and it was on that ground alone that relief was granted. While it appears that a prospectus was issued and used in obtaining subscriptions, there is nothing in the report to indicate that the prospectus was false, and no reference is made in the opinion of the court to the prospectus or to misrepresentation as a ground of relief.

In *Hayward* v. *Leeson*, 176 Mass. 310, all the incorporators and all the persons who were at the time subscribers to the corporation sanctioned the payment to the promoters of seven hundred thousand dollars in stock for their services. The court held that this profit could none the less be recovered, because pursuant to the scheme of the promoters, further subscribers were obtained and stock issued to them. The Court said:

"It is true that the vote, authorizing the issue of this stock to them as the profits which they were to have for the organization of the company, was voted unanimously by all the incorporators of the East Tennessee Land Company and by all who were then subscribers to its capital stock, that is, by all the persons who then had any interest in that corporation; in short, it is true that the fact, that the promoters were to receive $700,000 of paid-up capital stock as remuneration for their services, was disclosed, and consented to, by all the persons who then had any interest in the corporation. But it is also true that at that time no person except the promoters had any interest in the corporation, barring one Mason, in whose name some of the options were subsequently taken, and who was plainly a mere nominee of the promoters; and that at that time no capital stock of the corporation had been issued to the public." 176 Mass. 319.

In *Old Dominion Copper Mining & Smelting Company* v. *Bigelow*, 188 Mass. 315, the Court by Mr. Justice Loring unqualifiedly reaffirmed the doctrine laid down in *Hayward* v. *Leeson*.

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 A. C.

1218, and in *Gluckstein* v. *Barnes*, (1900) A. C. 240, the companies had come formally into existence when the transactions afterwards set aside were carried out, and all persons who at that time were interested approved, but as the approval was that of the wrongdoers themselves and they purposed obtaining and did obtain, in order completely to carry out their plan, other subscribers, the approval was deemed nugatory.

In the case of *Re British Seamless Paper Box Co.*, L. R. 17 Ch. D. 467, the point under consideration was clearly brought out. A corporation was there formed to take over a going business. No stock was issued to any outsider, and it was not intended so to issue any. Two years later additional stock was issued and in winding up proceedings it was held that towards the subscribers for this stock there was no duty on the part of the promoters, because the issue of that stock was no part of the original plan and promotion. Sir George Jessel based his opinion that there was no promoter's liability explicitly on the ground of

"The subsequent allotment of a portion of the shares not being part of the scheme originally contemplated." P. 475.

At the same time he said:

"I quite agree to this, that if promoters make an arrangement to get a profit for themselves out of what is apparently paid to the vendors, it is immaterial whether the contract with the vendors is approved of by the directors of the company, who are the promoters, just before the allotment or just after: in both cases it is intended to cheat the future shareholders; and of course it makes no difference whatever that the persons who, at the time the allotment was made, were in fact the promoters or their nominees, knew of the fraud. You can defraud future allottees as well as present allottees."

Lord Justice James said, speaking of the promoters:

"If they were intending, though then constituting the whole company, that other people should come in afterwards to whom what had been done would be injurious, the Court would feel no difficulty." P. 477.

In the same case Lord Justice Brett said:

"If when parties are promoters of a company and then become directors, and at the time when they are making a profit to themselves are intending to act not only for the then members of the company, but for future members, and they keep it secret, they can be made liable to account by future shareholders under the 165th section." 17 Ch. D. 477.

These views were approved in *Re Leeds & Hanley Theatres*, (1902) 2 Ch. 809.

Any other result would be deplorable. There is no difference in principle between inducing persons to subscribe for stock before such a transaction and inducing them to subscribe after but as a part of the same plan. In each case alike they are induced to associate themselves with the promoters in a common enterprise, not on a basis of buyer and seller, to which the maxim *caveat emptor* may apply, but on a basis of joint action.

These principles are applicable to the case at bar. The sale made by Bigelow and Lewisohn to the plaintiff corporation was indisputably a sale by promoters to their corporation. Indisputably there was no independent representation of the corporation. The transaction was therefore voidable unless validated by the unanimous acquiescence of all persons interested. It is not enough to show that the promoters and their employees were the only persons who at the time had actually become shareholders, and that they assented to their own act. It must be shown that no other persons were then in substance interested, and that it was not intended to bring in any others as a part of promotion.

FOURTH

IN THE CASE AT BAR THERE WERE PERSONS INTERESTED WHO DID NOT KNOWINGLY ACQUIESCE IN THE SALE.

I

There were stockholders in the corporation on September 18, 1895, when the transaction was completed, who did not acquiesce.

The Circuit Court and the Circuit Court of Appeals disposed of the bill on the ground that the promoters were the only persons interested in the corporation at the time the transaction complained of took place. Judge Lacombe expressly based his opinion on the absence of any other stockholders or subscribers. (136 Fed. R. 915.)

Leaving for the moment the rights of future stockholders, who are brought in as part of the promoters' plan, it is not true that at the important moment there were no other stockholders or subscribers.

The bill alleges that on July 11, 1895, an offer was made by Lewisohn to convey the mining claims to the corporation for thirty thousand shares and that by direction of Lewisohn and Bigelow the directors voted to accept the offer. On September 18, 1895, the directors voted to issue the thirty thousand shares and the mining claims were conveyed. The actual sale to the corporation was not made until September 18. The promoters did not take their profit until then. Only by the action of the directors on that day did it become possible for the promoters to secure this profit. Up to that time the transaction was *in fieri*. An offer had been made and a vote passed accepting it, but so far as appears no other action had been taken, no agreement had been executed, no conveyance made and no payment of consideration by the corporation. Not until September 18, 1895, was the matter closed, and

then it was Bigelow and Lewisohn, the promoters, who "caused" the board of directors to complete the transaction by voting to issue the shares.

On September 18, Bigelow and Lewisohn dominated the corporation. None of the capital stock had been actually issued. They were still acting as promoters and directing the affairs of the corporation. When on that date they caused the corporation to pay the thirty thousand shares of stock for practically worthless property they committed a breach of fiduciary duty both as directors and as promoters. For this act, by which they took this large secret profit, they are accountable as much as they would have been for then taking an additional secret profit.

Since September 18, 1895, is the date of the act by which the wrong complained of was accomplished, it is the date material in determining whether there were others interested or whether it is true, as the Circuit Court of Appeals said, that at the time of the transfer Bigelow, Lewisohn, and their representatives owned the entire issue of stock.

At the time when the transfer was made twenty thousand shares of stock had been subscribed for by outsiders, who knew nothing of the secret profit; and these subscribers subsequently paid for their shares, and by the very vote directing the payment to the promoters the issue of these shares to the subscribers was ordered. Moreover, at this time the members of the Old Dominion Syndicate had become entitled to the shares which were allotted to them.

Clearly the judges of the courts below were in error in assuming that at the time of the transfer — the act now complained of — only the promoters were concerned. The vote passed on July 11, 1895, was undoubtedly a breach of fiduciary duty, but the transaction which this vote contemplated was not carried out until September 18; the transfer which is the basis of complaint was not made until then, and on that date there were innocent subscribers for twenty thousand shares concerned, to say nothing of the syndicate members.

It will be shown that even if the transaction had been completed on July 11 the acquiescence of both the subscribers and the syndicate members would have been essential to its validity, but the allegations of the bill in fact set forth that the transaction was not completed until September 18, at which time the subscriptions for the twenty thousand shares had all been obtained. The decisions in the courts below, therefore, based on the supposed absence when the transfer was made of outside stockholders or subscribers, or on ownership at that time by the promoters of all the capital stock, are palpably erroneous.

II

The subscribers for the twenty thousand shares issued for cash were persons interested, who did not acquiesce.

The plan originally conceived by Lewisohn and Bigelow was to acquire control of the property of the Baltimore Old Dominion Company, to resell that property to a new corporation at a large advance, and to furnish the new corporation with working capital by offering part of its stock for subscription (Bill, par. Third, Rec. p. 3). This plan was carried out precisely as planned. Lewisohn and Bigelow sold to the new corporation on July 11, 1895, all the property of the Baltimore Company, except its cash assets, and sold also the mining claims which are the subject of the present suit. The new corporation thus became endowed with property, but it remained necessary to provide it with working capital. This necessity, which had been foreseen, was met one week later by offering stock to the public as originally planned. The whole operation was completed in September by the issue of all the stock, part for the mining property, part for the mining claims, and part for the cash subscriptions.

It is alleged in the bill and admitted by the demurrer that this means of providing a working capital was a part of

the plan originally formed. Obviously it was necessary for the successful promotion of the corporation that it should be supplied with working capital. This might have been done wholly or in part by Lewisohn and Bigelow themselves offering to furnish the property and the working capital in exchange for stock. Such was the nature of the contract considered by this Court in *Dickerman* v. *Northern Trust Co.*, 176 U. S. 181, and there deemed to result in a plain violation of the promoters' duties.

By whatever rule the relation of the promoters to the subscribers for these shares is tested, the subscribers were entitled to the protection of the principles determining promoters' liability. At the time the sale here complained of was made, the promoters, to apply the language of Lord Justice James, " were intending, though then constituting the whole Company, that other people should come in afterwards to whom what had been done would be injurious."

The subscribers were persons whom the promoters caused to be associated with themselves in order to carry out their plan, give success to their enterprise, and make possible the large profit they sought to secure; persons who were invited to join the corporation because the plan of the incorporators required that working capital should be furnished, and had provided this means of securing it.

The fact that the shares were not offered for subscription until a week after the sale of the mining claims cannot be material. It was still the promoters who caused the corporation to offer the shares for subscription, and to do so was an essential part of their scheme and necessary to its success. Their fiduciary duty still continued. To hold otherwise is to deny the statement of Sir George Jessel that " it is immaterial whether the contract with the vendors is approved by the directors of the company, who are the promoters, just before the allotment or just after " (17 Ch. D. 467, 471) and to deny the possibility of a promoter defrauding future stockholders. Applying the test laid down in *Tompkins* v. *Sperry*, 96 Md. 560, 582, other persons than the promoters themselves were " induced to

come into it by concealment or misrepresentation of the facts" and "have furnished all or part of the capital embarked in the enterprise." In the present case concealment and not misrepresentation was the means employed.

The fact that the money paid for these shares supplied working capital instead of being used in payment for the property is immaterial.

The capital furnished by the subscribers was as essential to the success of the enterprise, whether the promoters intended to achieve success in the stock market or in the operation of the mine, as money used to purchase the mining property. It is not true that when promoters from their own funds and from public subscription for stock provide a corporation with fixed and working capital, they can protect themselves from liability, whatever frauds they commit, by using the contributions from the public as working capital and not fixed capital. It is difficult to conjecture how such a rule could be defended or how reconciled with the view taken by this Court of the transaction in *Dickerman* v. *Northern Trust Co.*, 176 U. S. 181.

The judge of the Circuit Court and the judges of the Circuit Court of Appeals appear to have assumed that the issue of the shares was a transaction independent of all that went before, to be dealt with as if it had been an increase of capital at some indefinite future time, after the promoters had accomplished their purpose and had ceased to act as such. It is unnecessary to discuss the question thus raised as to the rights of subscribers for an issue of stock forming no part of the promoters' enterprise, for the assumption is contrary to the allegations in the bill. The issue of the twenty thousand shares was an integral part of the promoters' plan, and was necessary in order that the corporation should be more than a name. It was the means provided for furnishing working capital of which otherwise the corporation having purchased none of the cash assets would be wholly destitute. Until this part of the plan was carried out the corporation could do nothing.

The promoters planned from the outset to bring in these subscribers, in order to obtain from them the means of operating the mine (Bill, par. Third, Rec. p. 3). It was pursuant to this plan and for this purpose that the promoters caused the corporation to offer the stock for subscription (Bill, par. Fifteenth, Rec. p. 9). The issue of this stock and of all the other stock was authorized simultaneously (Bill, par. Sixteenth, Rec. p. 9).

Counsel for the appellees have contended that the subscribers for these shares were only vendees from the corporation, and that it does not appear that they were informed of Lewisohn's and Bigelow's plan, or that the subscriptions were based upon anything done or intended by the promoters. The subscribers were vendees in the same sense as if they had subscribed before the sale complained of was made, in the same sense as every subscriber for stock upon the original issue by a corporation is a vendee, and in no other sense. This suit does not involve as counsel seem to suppose any complaint against the corporation for disposing of the stock. Nor is the right of recovery based on any misrepresentation by which these individuals were led to subscribe. The right rests upon the fact that these individuals were persons towards whom the promoters stood in a fiduciary relation. They were persons whom the promoters intended to bring in as members of the corporation. They were " future allottees " who as well as present allottees might be defrauded. Persons whose right to protection is precisely the same in principle and on the authorities as if they had subscribed for stock before the offer was made. The continuity of purpose on the part of Bigelow and Lewisohn, their intentions and the objects which they had in view are not set forth as facts which influenced the action of the subscribers for stock, but as showing what would perhaps be sufficiently apparent without, — that the entire course of proceedings down to the issue of all the stock was one transaction and not several.

The real ground of complaint is that Lewisohn and Bigelow concealed from these subscribers the fact that they,

Lewisohn and Bigelow, had made a contract very much to their own advantage, acting in anticipation of the subscribers becoming stockholders, and while intending them to do so. It is wholly immaterial in such a cause of action whether the subscribers knew that Lewisohn and Bigelow intended the proceeds of this stock to supply working capital or not.

The learned counsel for the appellees have contended also that there could be no fiduciary relation between the promoters and these subscribers because such a relation must result, if at all, from some agreement to that end, express or implied, between two or more persons. In no case has it been held that the fiduciary relation of a promoter must arise from an express contract, or from an implied contract, except such contract, if one chooses to call it so, as may be implied from the mere transaction. In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 A. C. 1218, for example, the shares of the company were offered, as here, for public subscription. The prospectus created no contract. If the prospectus was false and created a liability, it was, as Lord Blackburn pointed out, a liability to the individual and not to the company, yet the company was entitled to rescind because of the breach of fiduciary duty on the part of the promoters in not disclosing the profit they were making.

Finally, counsel for the appellees have contended that there was no injury done to the corporation or to the subscribers. The wrong complained of is the sale to the corporation for thirty thousand shares of its stock of property which cost the promoters nothing, and was practically valueless. The corporation for no consideration parted with shares that were worth seven hundred and fifty thousand dollars. Yet it is said the corporation lost nothing. The subscribers for shares received shares which were necessarily worth less than if thirty thousand other shares in the corporation had not been issued for no value. If the promoters had sold their property without taking this profit, either the corporation would have had thirty thou-

sand shares less outstanding, and each share would have been so much the more valuable, or its assets would have been increased by the proceeds of thirty thousand shares issued for value. The fact that the shares had a market value equal to the subscription price does not show that the subscribers lost nothing if, in fact, their shares would, but for the promoters' wrongdoing, have been more valuable. In an action at law for deceit the cost of the property to the vendor might, in the absence of a misrepresentation, be no concern of the subscriber, and this is the rule which counsel for the respondents lays down as controlling the present case, but it has uniformly been held in a question of fiduciary relations that the cost of property to a trustee who sells it to his beneficiary is a matter of concern to the beneficiary, of concern so deep that if undisclosed the sale may be set aside.

As to the offer to sell made and accepted on July 11, 1895, the subscribers are persons brought in by the promoters, after the act indeed, but as part of the original plan; as to the actual completion of the sale, issue of the stock and taking of the profit they are persons who at the time of the act had become subscribers for stock; as to each act alike their acquiescence was necessary.

III

The members of the Old Dominion Syndicate were persons interested who did not acquiesce.

Even if no shares had been offered to the public for subscription, the promoters would have been liable for nondisclosure to and lack of acquiescence by the other members of the Old Dominion Syndicate. The members of the syndicate were persons interested in the corporation and in the enterprise at the time of the sale, and their assent was necessary to give validity to the act of the promoters as directors under which they took this profit to themselves as vendors.

The Old Dominion Syndicate was formed to provide money with which to purchase the property or stock of the Baltimore Old Dominion Company with a view to its resale. Lewisohn and Bigelow acted for the syndicate; with its money they purchased the stock in the Baltimore Old Dominion Company by control of which the sale to the corporation was made. The proceeds of the sale to the corporation was the property, in equity at least, of the syndicate, and eighty thousand shares of stock were divided among its members in recognition of this right.

The members of the syndicate were not stockholders at the time the sale complained of was made, but it has been shown that this is immaterial if they were persons intended by the promoters to become stockholders. The members of the syndicate were such persons; they did become stockholders pursuant to the original plan of the promoters for carrying out the enterprise. They joined in the common enterprise of forming the corporation to take over the mining property.

The stock of the Baltimore Old Dominion Company, the ownership of which enabled the property of that corporation to be sold for stock to the plaintiff, was purchased with the syndicate's money. The members of the syndicate were in equity entitled to the proceeds of what their money purchased. The syndicate contract provided that the members should share *pro rata* in the profit of the sale to the new corporation (Bill, par. Fourth, Rec. p. 4). They took the stock allotted them therefore as of right, precisely as if each had subscribed for that amount of stock, his subscription being payable by assignment of his undivided interest in the property transferred. Had the syndicate acquired the property which was transferred to the corporation and then agreed to transfer it in exchange for stock, the relation of such members would have been precisely the same as that of the complaining stockholders in *Dickerman* v. *Northern Trust Co.*, 176 U. S. 181. What they might have done directly, the syndicate, as a matter of convenience, did indirectly; each member by his contri-

bution became entitled to a share as *cestui que trust* instead of as tenant in common. Lewisohn and Bigelow managed the syndicate, but they were responsible to its members. The stock allotted to the members of the syndicate came to them exactly as if given in satisfaction of a subscription made for them by their managers.

It has been objected on the part of the respondent that the syndicate contract was not with the corporation, created no relation between the corporation and the members, and, therefore, could not be the basis of any recovery by the corporation; that the syndicate members did not acquire their stock from the corporation, but from the promoters, and that because the syndicate was formed to make a profit from the sale of the mining property, the members could not complain of another profit made by Lewisohn and Bigelow alone from the sale of the mining claims. All of these objections are founded on the misapprehension of the facts or of the rules of law applicable.

The syndicate contract is not relied upon as the basis for recovery by the corporation. That contract was made between the promoters and the syndicate members, each representing only himself. For a breach of that contract the remedy would not be an action by the corporation, but an action by the individuals concerned. That contract, however, entitled the syndicate members to become stockholders in the corporation. They did become stockholders. It was intended by the promoters that they should become stockholders and should furnish the money for acquiring the property sold. They are, therefore, within the class of persons to whom a fiduciary duty is due as much as if they had subscribed for shares instead of for membership in the syndicate subsequently to be converted into shares.

The members of the syndicate being then by virtue of the syndicate agreement in the same position as shareholders, the promoters as to them were under the usual fiduciary duty of a promoter. The sale of the mining claims was not a transaction governed by the syndicate agreement. It was a separate transaction with reference

to which the syndicate members had the same right to disclosure as any other intended member of the corporation, a right founded not on the terms of their contract, but on the obligation due to them as future stockholders, the same obligation adverted to by this Court in *Dickerman* v. *Northern Trust Co.* as protecting persons who, pursuant to independent contracts with the promoters, contracts made when no fiduciary relation existed, were to become stockholders. When Lewisohn and Bigelow took their profit from the sale of the mining shares they did not violate the terms of the syndicate agreement, but they violated the duty owing to the syndicate members as future stockholders, made such by the rights given them through the syndicate contract.

The case as to the members of the syndicate is precisely the same as that presented in *Arnold* v. *Searing*, 67 Atl. Rep. 832, decided in the Court of Chancery of New Jersey. In that case a bill was filed to recover profits made by promoters who had issued " syndicate shares " to obtain money with which to take up options on stock in a corporation with a view to merging that corporation with a new corporation. The merger was effected; securities of the corporation thus created were issued to the promoters as the stockholders in the old corporation, and by them distributed pursuant to the syndicate agreement, but the promoters retained a large profit. Members of the syndicate who had thus acquired, nominally from the promoters, shares in the new corporation brought a stockholders' bill to enforce the claim of the new corporation to recover the secret profit. The Court held that the suit could be maintained, — that the syndicate members occupied in substance the same position as if they had received their shares directly as original subscribers.

The position of the syndicate subscribers is not analogous to that of persons who have by contract made while dealing with promoters at arm's length undertaken to accept a specified amount of stock out of a total specified capitalization in payment for their property. In the latter case

if the specified stock is delivered there is no ground of complaint. The promoter in making his bargain has dealt with an independent person to whom he was under no duty and the transaction with the corporation is merely a consummation of the preliminary bargains.

There is no evidence that in this case the syndicate members joined in a plan to make, to the extent of the profit shared by them, a profit not disclosed to other stockholders. If such were shown to be the case, it would not be material, because that profit is not now in question. Their complaint is that the promoters who as to them were under the usual duty of promoters took in a separate transaction a secret profit. They are in no way estopped as holding stock received from the promoters, because their right to stock arose from their subscriptions, and the shares they actually received came not from the promoters but from a man of straw who received for convenience and distributed directly to the persons interested the whole consideration received for the mining property.

The real test of whether persons who become members of a corporation are, at the time a sale to it is made, in such a position that their acquiescence is necessary to validate the sale, is whether they became members pursuant to the plans of the promoters; whether it is a part of the enterprise that such persons shall join the corporation; whether the scheme of the promoters is incomplete and not finally carried out until they do so. If under such conditions a person acquires stock by direct subscription, he is in a position to complain through the corporation if a secret profit is taken, whether the subscription is before or after the transaction complained of. Equally, if he acquires his stock not directly from the corporation, but indirectly, according to a prearranged plan for the issue of the stock and the promotion of the enterprise, he may complain through the corporation.

See *Brewster* v. *Hatch*, 122 N. Y. 349.

If, on the other hand, he acquires his stock by mere purchase from the promoters, no question of fiduciary duty arises.

Counsel for the defendants has contended on the authority of *Hutchinson* v. *Simpson*, 92 App. Div. 382, that nondisclosure was as to the members of the syndicate no breach of a fiduciary duty. In other words, that the approval of the promoters themselves prior to the syndicate members becoming stockholders was a binding acquiescence. The facts in the case referred to are not so parallel to the facts here as to warrant this conclusion. In that case, according to the interpretation put on the facts by a majority of the Court, all the stock was issued to Moore and Schley for property which they purchased and transferred to the corporation. So far as appears, Moore and Schley were under no obligation to any one as to the disposition of this stock except so far as they had made contracts to sell it or to transfer it in payment of personal obligations of themselves or their agent. The disposition of the stock was deemed to be a part of their plan only as it would have been if they had previously arranged to obtain money by pledge of the stock. On the other hand, in the present case the syndicate members were to become stockholders and did become stockholders as joint adventurers pursuant to the original plan, and if the corporation had been composed only of them and the promoters, the corporation, as representing their collective rights, could have maintained this suit for breach of the fiduciary duty of the promoters.

IV

There was clearly no disclosure and therefore no acquiescence if persons other than the promoters themselves were concerned.

If it is once established that the acquiescence either of the subscribers to the twenty thousand shares or of the syndicate members was necessary to validate the sale, it is clear

that there was no disclosure and so there could be no acquiescence. Only on the theory that the vote of the promoters as directors, passed when there were only forty shares of stock outstanding, bound all future stockholders, because the knowledge of the holders of the forty shares constituted knowledge by the corporation, can it be pretended that there was any disclosure. Neither the subscribers nor the syndicate members, other than the promoters, had any knowledge that thirty thousand shares were being taken as a profit on the sale of substantially worthless property.

Where promoters are in absolute control and with their agents constitute all the members of the corporation for the time being, there can be no disclosure and no knowledge binding upon the corporation or future members.

Lord Macnaghten in *Gluckstein* v. *Barnes*, (1900) A. C. 240, 249, said as to such a case:

> "With all deference to the learned counsel for the appellant, that seems to me to be absurd. 'Disclosure' is not the most appropriate word to use when a person who plays many parts announces to himself in one character what he has done and is doing in another. To talk of disclosure to the thing called the company, when as yet there were no shareholders, is a mere farce. To the intended shareholders there was no disclosure at all. On them was practised an elaborate system of deception."

Counsel for the appellees have argued that disclosure of this profit was not "a practical course." That such a disclosure would have prevented carrying out their scheme, and in that sense was not practical, is true; but in no other sense is there any difficulty. The requirement of disclosure does not extend, as this argument suggests, to future dealings in the stock. It has never been deemed necessary for a promoter, in selling in the ordinary course stock which he has acquired, to inform the purchaser of the facts as to the bringing out of the company. The duty of disclosure rests upon the promoters with respect to those persons who become members of the corporation, at their instance, as

part of their scheme for floating the enterprise. It is a duty that may be performed by publishing a truthful and candid prospectus or by giving notice to the individuals, or in any other manner that actually and effectually apprises those persons of the facts, so that they may properly be held to have approved or acquiesced in the transaction.

At the time the sale complained of was made forty shares of stock in the corporation had been subscribed for. The relation of these subscribers to the corporation as members was of such a formal nature that the directors at once proceeded to dispose of the entire one hundred and fifty thousand shares of authorized capital as if no shares were outstanding. Obviously the promoters meant to deal with a corporation having actual members. Obviously they intended that there should be a full body of stockholders. Obviously the persons who joined the corporation pursuant to plans originally formed by the promoters, and in the orderly and expeditious carrying out of those plans, were persons to whom, according to all the authorities, the promoters owed a fiduciary duty. Yet it is seriously contended that because the promoters in their capacity of directors voted to purchase from themselves, when only forty shares of stock had been subscribed, — shares which were subsequently disregarded in the actual issue of the stock, — the corporation and all its members are to be held bound by acquiescence, whereas if the plans of the incorporators had been carried out in precisely the same manner except that the shares for working capital had been subscribed for and the shares for the syndicate allotted before instead of after the sale, the promoters would have been liable. If the liability of promoters rested upon some arbitrary rule of law, such an irrational and unintelligent distinction might be a necessity. But the liability, far from being the result of an arbitrary rule of law, is a practical application of deep-rooted and fundamental principles of equity. To make its enforcement depend upon the form instead of the substance of a transaction is to cause a serious miscarriage of justice.

FIFTH

THE CASE AT BAR IS ENTIRELY DIFFERENT FROM THOSE CASES IN WHICH THE PROMOTERS TAKE ALL THE STOCK AND SUBSEQUENTLY SELL PART TO OTHER PERSONS.

The decision of the Circuit Court and of the Circuit Court of Appeals apparently proceeded upon the theory that because at the time the offer was made and accepted the only members of the corporation were the promoters themselves, who necessarily knew of and acquiesced in the sale, therefore there could be no cause of complaint. This view proceeds upon a confusion between two vitally distinct classes of cases.

If the owners of property determine to form a corporation to take over the property and in pursuance of that plan sell to the corporation so formed, themselves taking all the stock, they act for no one but themselves. It is not a part of their plan for any one else to come in; no one joins with them in the enterprise; no one is interested but themselves; they have no beneficiaries; and they are under no fiduciary duty. If they subsequently as an unconnected transaction sell stock they are under no fiduciary duty to the purchasers. Such a case was that of *Re Ambrose Lake Tin & Copper Mining Co.*, 14 Ch. D. 390.

If on the other hand the promoters organize a corporation to buy their property and as a part of their plan propose to have and do have others join with them, so that their plan is in part at least carried out by the use of other people's money, whether that money is used to provide the corporation with fixed capital or with working capital, then there are others interested; the promoters in such a case act for the persons whom they design to bring in; those persons are their beneficiaries; to those persons they owe a fiduciary duty; and for any breach of such duty those persons are entitled through the corporation to relief.

In the one class of cases there is a purchase of stock and no relation except that of vendor and purchaser. In the other class of cases there is a joint enterprise in which the subscribers for stock are interested with the promoters, the promoters act as the agents and representatives of all those interested, and there is a fiduciary relation. The distinction between the two classes of cases has long been recognized. Mr. Morawetz after discussing the case of frauds by promoters of which *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, is typical, and pointing out the right of the corporation, as representing the collective corporate rights of the shareholders to recover, says:

"On the other hand, in *Parsons* v. *Hayes*, and *Re Ambrose Lake, etc., Mining Co.*, the collective rights of the shareholders were not infringed. The charge made in these cases was, that the directors had issued the entire stock of the company as paid-up stock, for property worth less than the par amount. No person was injured in the least degree by these transactions. If the persons to whom the stock was first issued afterwards sold a portion of it, and deceived the purchasers by a false representation that the par value of the shares had been paid into the company's treasury, they would clearly be liable to the purchaser for the fraud. And under these circumstances the directors who issued the false certificates representing that the company's capital had been paid up according to law might perhaps be charged also by reason of their complicity. But in a case of this kind the plaintiff's claim would be merely for the damages caused by the deception, and the extent of the injury would depend in each case upon the price paid by the plaintiff for the shares, and their market value when the deception was discovered." 1 Morawetz on Private Corporations, 2d ed., sec. 292.

All the cases relied upon by the appellees and all the cases relied upon by the Circuit Court of Appeals as showing that in the present case there was no wrong done the corporation, belong to the class of cases referred to by Mr. Morawetz. In all the transaction complained of was a sale to a corporation for its whole capital stock. All the

stock was issued to the alleged wrongdoers. No other person was connected with the enterprise or became connected with it, and it was not a part of the plan that any other person should become connected with it except as a purchaser of stock from the promoters. All those persons who, by becoming members of the corporation, completed its formation, made it more than a skeleton, and constituted it a going concern, acquiesced in the transaction. No person became a member of the corporation as a part of the plan for its formation without full knowledge and acquiescence. No individual was injured except by paying too high a price for stock already issued and outstanding.

In *Foster* v. *Seymour*, 23 F. R. 65, one of the cases relied on, the bill alleged that the trustees of a corporation issued all its capital stock to themselves, in exchange for property owned by them, and "after such exchange of the capital stock, divided and distributed it among themselves, and sold it as fully paid stock to innocent purchasers, including the complainant." The Court necessarily held that the sale to the corporation was valid; the stock might not be fully paid for, the persons who bought the stock subsequently might suffer from paying too high a price, but the vendors had made no profit except by selling, for more than it was worth, stock belonging to themselves.

In *McCracken* v. *Robison*, 57 F. R. 375, another case relied on, certain persons formed a railroad company, and had the corporation contract with the defendants that the latter should turn over the road fully constructed and equipped in return for all the capital stock and bonds. Simultaneously the defendants agreed to pay the promoters half the profit made from the sale of the stock and bonds. Subsequently for this latter agreement was substituted a promise to pay a specified sum. The defendants sought to avoid this promise on the ground of illegality. The Court held that no breach of fiduciary duty was shown. The only persons interested in the enterprise were

the promoters themselves. Whoever became interested in the stock of the corporation acquired such interest only by purchase from the persons who contracted with the corporation.

Stewart v. *St. Louis, etc. R. Co.*, 41 F. R. 736, was a precisely similar case. All the stock of a railroad corporation was issued in payment for the railroad to the persons who controlled the corporation. No one else was concerned.

In *Parsons* v. *Hayes*, 14 Abbott N. C. 419, all the stock in the corporation was issued to the vendor, who, by agreement, turned over a part of it to the directors for their personal benefit. Subsequently shares were sold by them or by the vendor. The plaintiff was a purchaser of shares, and sought by a stockholder's bill to make the directors account for the difference between the par value of the stock issued and the real value of the property. The Court held that the suit could not be maintained.

In *Barr* v. *New York, L. E. & W. R. R. Co.*, 125 N. Y. 263, a suit was brought by a minority stockholder in another railroad company to enforce payment of rental by the defendant company. The plaintiff's right to sue was assailed on the ground that he received his stock under a contract that was fraudulent. The contract in question was for the construction of the road in exchange for all its stock and bonds. The construction contract was made for the benefit of a syndicate comprising all the directors and stockholders of the company. The Court said:

> "As the members of the syndicate were practically the company and composed the whole number of stockholders, there was no one to object." P. 273.

No one was concerned in the corporation except the members of the syndicate, and no one could or did become interested except by purchase from them. On this ground the Court held that the plaintiff's right to sue could not be impeached. The contract of lease on which the plaintiff sought to recover was impeached on the ground that it

was made by the directors of the Erie Railroad Company, the defendant's predecessor, for the benefit of themselves as stockholders in the lesser corporation. The Court held that though the contract was voidable in its inception, it had been ratified by knowing acquiescence.

In *Seymour* v. *Spring Forest Cemetery Assoc.*, 144 N. Y. 333, co-tenants sold real estate to a corporation, formed by them for the purpose, taking in payment bonds of the corporation. The Court held that the sale could not be impeached because the vendors were themselves all the persons interested.

"If they were the vendors on the one hand, dealing with themselves in a corporate capacity on the other, they were also the sole beneficiaries to be affected, and could not defraud themselves. . . . As beneficiaries, the stockholders necessarily assented to all the details of the arrangement, and no just criticism is possible either upon the legality or morality of the transaction." 144 N. Y. 340.

In *Hutchinson* v. *Simpson*, 92 App. Div. 382, an attempt was made to recover stock taken by Moore and Schley, as a profit on the organization of the American Malting Co. The facts showed that Moore and Schley entered into contracts with various persons by which the latter undertook to take stock in a corporation to be formed for the purpose of acquiring various plants on which Moore and Schley had options. The plants were turned over with a specified sum in cash for working capital in exchange for all the stock in the corporation. Moore and Schley then distributed the stock among those who had agreed with them to purchase it, and retained a large surplus remaining as an undisclosed profit to themselves. Three out of the five members of the court were of opinion that there was no cause of action, because the transaction by which the stock passed to persons who had agreed to take it was a sale to them by Moore and Schley, and not a contract between them and the corporation. The other two members of the Court were of opinion that in substance the transaction was

a subscription for stock, and that Moore and Schley were liable as promoters. Judge Patterson, one of the majority, in concurring (p. 407), expressly approved the doctrines of law laid down by the minority, while holding them inapplicable to the facts. The case was taken to the Court of Appeals, but was settled before it was reached. It may well be questioned whether the decision of the majority of the Court as to the facts was well founded. There would seem to have been good ground for contending that in reality the persons who purchased stock from Moore and Schley were in substance original subscribers; but however this may be, the decision deals only with the interpretation to be put upon the particular facts of the case.

Insurance Press v. *Montauk F. D. Wire Co.*, 103 App. Div. 472, was similar to *Parsons* v. *Hayes*. All the stock was issued to certain persons in exchange for certain patents. No one was concerned in the transaction complained of except the parties to it. Outside stockholders, including the plaintiff, became such subsequently as purchasers.

Tompkins v. *Sperry*, 96 Md. 560, is much relied on by the appellees. In that case the promoters took all the stock of the corporation in payment for property which they transferred to it. They had purchased certain property, they sold it to the corporation for all the capital stock, and disposed of the latter for their own benefit. The Court said of the transaction:

"It is entirely consistent with the exhibits on which the allegations of the bill rest that these gentlemen should have purchased the properties on their own account with a view to capitalize their combined value by turning them into the company in payment for its bonds and stock." 96 Md. 579.

Distinguishing the case from those in which a fiduciary duty is violated, the Court said:

"The true test of the responsibility of parties occupying positions such as Sperry & Jones did in putting the brewing properties into the company in this case, is whether other persons than themselves hold stock in the company and are not made aware of the

true state of facts, or are induced to come into it by concealment or misrepresentation of the facts, or have furnished all or part of the capital embarked in the enterprise and are misled or kept in the dark as to the actual transaction." 96 Md. 582.

The case of *Blum* v. *Whitney*, 185 N. Y. 232, is of the same character. There the Distilling Company of America was formed pursuant to a written agreement which stated that a certain amount of stock was to be issued for each of certain specified properties. The ground of complaint alleged was that one of the properties, The Hannis Distilling Company, was acquired by persons interested in the formation of the Distilling Company of America at a price which gave them a profit. The Court of Appeals of New York held that the bill showed no cause of action because the distribution of the stock was expressly agreed upon by all the persons interested. The Court said:

"The stockholders of the constituent companies and the individual defendants were the organizers of the corporation and became its first stockholders; they dealt wholly between themselves as sellers and buyers, organizers and corporations; no other persons had any interest in this initial transaction." P. 241.

Each of the persons interested in the original issue of stock deliberately assented, by becoming a party to the agreement, to the allotment of stock among the various properties to be acquired. The promoters who had themselves acquired the Hannis Distilling Company did not assume to decide for their associates the price at which that property should go into the new corporation. Their original proposal was that the Hannis Distilling Company should receive an amount of stock shown by the agreement, and all persons who joined in the new corporation, exercising their independent judgment and discretion, voluntarily acquiesced in that allotment. The bargain for the benefit of the promoters was really made not between them and the corporation when the latter acquired their property, but between them and the several individuals who joined in the agreement to form the corporation, when the

latter assented to the price proposed. The sale to the corporation was merely the consummation of the agreement already made, and in making that original agreement the promoters acted only for themselves and at arm's length.

The English authorities show the same distinction.

In *Salomon* v. *Salomon*, (1897) A. C. 22, there actually was but one man interested in the formation of the corporation; he owned the corporation as he owned the business which was sold to the corporation. No profit which he took in making the sale to the corporation, no over-valuation of the property transferred, could affect any person.

In *Ambrose Lake Tin & Copper Mining Co.*, 14 Ch. D. 390, the owners of a mining enterprise formed a corporation and took all the stock in payment for a transfer of the mine. No one was concerned except the original owners of the property. No one could thereafter become concerned except by purchase from them. The Court held that as all persons interested had acquiesced the transaction was necessarily valid.

Re British Seamless Paper Box Co., L. R. 17 Ch. D. 467, followed the earlier case in holding that upon the formation of a private company, where no stock is to be issued except to persons acquiescing, the transfer to the corporation is valid. In neither case was any doubt cast upon the general doctrine that without the consent of all persons interested a sale by promoters may be impeached.

There is no conflict of legal doctrine between any of the cases referred to. In none of the cases relied on by the respondents are the principles laid down in the case of *Erlanger* v. *New Sombrero Phosphate Co.*, and the cases following it, questioned. The distinction between the two classes of cases is a difference in the facts, not in the law applicable to the facts. In each of the cases referred to, where liability was denied, the Court rested on the ground that all the persons concerned had acquiesced, including among the persons concerned all whom it was intended should come in. The only possible criticism of any of the cases is as to the interpretation put upon the facts in deter-

mining whether certain persons who had acquiesced, and had not been informed, were concerned in the enterprise, and therefore in the transaction complained of, or were merely dealing with the promoters as individuals.

In the case at bar no such state of facts is presented. Neither in form nor in substance did the subscribers or the syndicate members obtain their stock from the promoters. The subscribers acquired their stock direct from the corporation as an original issue contemplated as part of the scheme of promotion. The syndicate members obtained their stock from a nominee of the Baltimore Old Dominion Company pursuant to the arrangement by which their money had been used to purchase that company; they also therefore virtually took their stock direct from the plaintiff as an original issue made as part of the scheme of promotion.

SIXTH

THE APPELLEES HAVE FAILED TO DISTINGUISH THE CASE AT BAR FROM THOSE CASES IN WHICH, BECAUSE A FIDUCIARY RELATION EXISTED TO PERSONS WHO DID NOT ACQUIESCE, THE TRANSACTION WAS VOIDABLE.

The appellees have advanced various grounds to distinguish the case at bar from those in which relief has been granted against promoters. None of these grounds are tenable.

They have argued that the subscribers for the twenty thousand shares had no connection with the enterprise, but were practically in the same position as subscribers for an increase of capital made at some indefinite future time. The argument disregards the fact that the subscriptions were obtained as part of the plan of promotion and to complete the transaction. The same argument would if sound have been fatal in the Erlanger case, in *Hayward* v. *Leeson*, and in *Yeiser* v. *U. S. Board & Paper Co.* In all of those cases the subscriptions were taken after the contract complained of had been made.

They have argued that the syndicate members cannot be regarded because they were not subscribers for stock and because their rights were regulated by the syndicate contract with which the corporation had no concern. The argument fails to take into account that while the syndicate contract imposed no fiduciary obligation on Lewisohn and Bigelow as promoters its effect was to make the syndicate members to all intents and purposes subscribers and as such entitled to the same protection as other subscribers. The syndicate contract was not, as in *Blum* v. *Whitney*, 185 N. Y. 232, an agreement made between independent contracting parties defining what each should receive. It was merely the means through which the members of the syndicate were introduced to participation in the enterprise substantially as subscribers for stock and as such in the usual relation to the promoters. In *Blum* v. *Whitney* the contract was one by which each person contracting with the promoters accepted a bargain for the largest amount of stock that he could get, knowing, when he accepted, what amount each of the others was to get.

They have argued that because no prospectus was issued here the authorities referred to are inapplicable. But the alleged distinction is untenable in principle, has been expressly repudiated by Lord Blackburn in the House of Lords and by the Supreme Judicial Court of Massachusetts, and has nowhere been relied on.

Counsel for the appellees in their brief before the Circuit Court of Appeals declared that none of the original subscribers for stock and none of the syndicate members had been found objecting to the transaction in question, and that this showed acquiescence and should prevent the sale being inquired into now. The record contains nothing to warrant these assertions. The only inaction which could show acquiescence would be inaction with knowledge of the facts. It is alleged in the bill (par. Twenty-second, Record, p. 15) that neither the subscribers nor the syndicate members knew of the facts, and that until April 4, 1902, when Bigelow ceased to be president, the appellant

had no knowledge or information as to the profit made. It does not appear therefore that there was any inaction on the part of the syndicate members or of the subscribers except as a result of ignorance of the facts. Any argument based on the assumption of inaction with knowledge must be disregarded as involving an unwarranted assumption of facts not before the Court.

In the final analysis the appellees' argument is the bare proposition that upon the formation of the corporation with forty shares of stock paid in the fiduciary relation of the promoters ended, and that from that time they were free to do whatever they themselves as the holders of the forty shares approved; that because the forty shares were the entire issued stock of the corporation at the time, therefore the acquiescence of the forty shares was the acquiescence of all persons interested. To support this proposition the appellees would have the remaining one hundred and forty-nine thousand nine hundred and sixty shares looked upon as stock reserved by the corporation for issue at some indefinite future time, although when the stock was actually issued one hundred and fifty thousand shares were issued, the prior issue of the forty shares being wholly disregarded.

Such a proposition is repugnant both morally and legally. It does not represent the business or the legal view of the actual facts, and it disregards an unbroken series of decisions.

Where, as in *Blum* v. *Whitney*, a certain amount of stock is designedly reserved for future use at some time after the transaction of forming the corporation and putting it in a position to transact its business is completed, the assent of all persons who up to the completion of the transaction are concerned may be sufficient. The stock reserved is to all intents and purposes in the same situation as stock which might be authorized by future amendment of the articles of incorporation and is unconnected with the inception of the enterprise. Such a case is utterly different from the position taken by the appellees that

whenever any stock has been issued the assent of the holders is sufficient, although the issue is only the first step in one transaction.

From a business standpoint the "floating" of the plaintiff corporation was not completed until all the stock which was to be issued in order to put it in a position to fulfil the purposes of its incorporation had been issued. From a legal standpoint the same thing is true, and the promoters could not deal with the corporation for their own benefit without the assent of all persons who became members of the corporation in carrying out the plan for its complete organization.

SEVENTH

THE PLAINTIFF CORPORATION IS ENTITLED TO A RESCISSION OF THE SALE AND A RETURN OF THE CONSIDERATION, OR IN THE ALTERNATIVE TO AN ACCOUNT OF PROFITS MADE BY THE SALE.

I

The right to relief is in the corporation and not in the individual stockholders.

The grounds on which relief may be obtained by a corporation, as distinguished from an individual stockholder, in cases like the present, have already been fully considered. The courts have uniformly given effect to these considerations and granted relief at the suit of the corporation.

Yeiser v. *U. S. Board & Paper Co.*, 107 F. R. 340.
Hayward v. *Leeson*, 176 Mass. 310.
Old Dominion Copper Mining & Smelting Co. v. *Bigelow*, 188 Mass. 315.
Yale Gas Stove Co. v. *Wilcox*, 64 Conn. 101.
Erlanger v. *New Sombrero Phosphate Co.*, 5 Ch. D. 73; 3 App. Cas. 1218.

II

Rescission is the appropriate relief.

It has always been assumed by the courts that a contract voidable because one of the parties stood in a fiduciary relation to the other could be rescinded at the option of the latter, unless there were special facts making such relief impracticable.

The right to rescind the contract clearly follows from the principles already laid down. Indeed, the meaning of calling the contract voidable is that the corporation has a right to rescind (1 Morawetz on Private Corporations, 2d ed., sec. 524), and, as an incident of such rescission, of course to recover the consideration paid.

Accordingly, it is the rule that sales to or other transactions with a corporation vitiated by the participation therein of directors or promoters adversely interested will be set aside at the instance of the corporation.

Wardell v. *Railroad Co.*, 103 U. S. 651.
Yeiser v. *U. S. Board & Paper Co.*, 107 F. R. 340.
Old Dominion Copper Mining & Smelting Co. v. *Bigelow*, 188 Mass. 315.
Hebgen v. *Koeffler*, 97 Wis. 313.
Erlanger v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218.
Lindsay Petroleum Co. v. *Hurd*, L. R. 5 P. C. 221.
Phosphate Sewage Co. v. *Hartmont*, 5 Ch. D. 394.

It may be presumed that on demurrer the Court will not say that rescission is impracticable.

III

The lapse of time is no bar to a rescission.

There is no rule of law requiring that a right to rescind be exercised within a prescribed time. The question in each case is whether the plaintiff seeking rescission has acted with reasonable diligence, and in determining this question the Court will consider the facts of each case. If there has been no delay to enable the plaintiff to speculate on the chances of the transaction proving profitable, no change in the condition of the property rendering rescission unjust, and a satisfactory explanation of the delay, mere lapse of time will not bar the right to relief.

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, the suit to rescind was begun about fourteen months after the sale complained of, and after operations had been carried on upon the island which was the subject of the purchase. But, as the suit was begun promptly upon the facts invalidating the sale becoming known, the Court allowed a rescission.

In *Lindsay Petroleum Co.* v. *Hurd*, L. R. 5 P. C. 221, the suit for rescission was begun a year and a half after the sale; but, as proceedings were taken promptly upon discovery of the facts, the Court held that the sale could be rescinded.

Rescission stands, so far as the lapse of time unaccompanied by other circumstances rendering it unjust or improper is concerned, on the same basis as recovery of secret profits. The cause of action is the same; the difference is which alternative relief shall be granted. The decisions of the courts in cases where relief has been granted in the shape of an accounting for profits, or recovery of damages on a sale vitiated by violation of duty on the part of one in a fiduciary position, are, therefore, of equal weight in determining whether the cause of action

is so barred by lapse of time that relief by rescission shall not be granted.

In *Hayward* v. *Leeson*, 176 Mass. 310, one of the defences set up was that the land sold had not been tendered back; in other words, that the plaintiff had not asked for rescission. In overruling this defence the Court said:

"If at the time when a fraud is discovered, which was perpetrated by promoters in a sale to the corporation of property owned by them, the property is no longer in the condition in which it was when the company took it, the company may, keeping the property, sue the promoters for the secret profits which it was their duty not to make without notifying the company thereof." P. 321.

The Court thus put the right to maintain a bill for rescission, and one for the alternative relief, on precisely the same ground.

In the case last cited the bill against the promoters of the East Tennessee Land Company was not filed until almost six years after the transaction complained of.

In *Bagnall* v. *Carlton*, 6 Ch. D. 371, a case to recover a profit made by the promoter, the suit was brought two years after the transaction.

Lydney & Wigpool Iron Ore Co. v. *Bird*, 33 Ch. D. 85, was a similar suit to recover profits made by a promoter. The bill was filed about ten years after the transaction complained of. The Court held that the plaintiff was entitled to recover.

In all of these cases the Court acted on the same principle, — that lapse of time was no bar as long as the suit was brought with reasonable diligence after the facts became known.

See also:

Alger v. *Anderson*, 78 F. R. 729.

In the present case there was no unreasonable delay in bringing suit after the plaintiff became aware of the facts and was free from the domination of the wrongdoers.

From the time of the plaintiff's organization until April 4, 1902, Lewisohn and Bigelow controlled the corporation. They chose directors, most of whom were personal friends, and chose Bigelow continuously to fill the office of president and chief executive officer (Bill, par. Twenty-second, Rec. p. 15). Within a few months after the domination of Bigelow and Lewisohn over the corporation ceased, this suit was brought.

IV

In the alternative, if for any reason the Court deems it improper to grant relief by rescission, the plaintiff is entitled to recover profits.

It is perfectly well settled that where rescission cannot be had, because the property has materially changed in character or for any other reason, the corporation may recover the profits made by the promoters from the obnoxious transaction.

In *Yeiser* v. *U. S. Board & Paper Co.*, 107 F. R. 340, the Court said there could be no rescission without injustice, because the property purchased had been in active use and could not be given up without injury to the corporation; but the Court allowed the recovery of the profit made by the promoters.

In *Chandler* v. *Bacon*, 30 F. R. 538, the Court held that promoters who had negotiated the sale of a patent to a corporation and had by arrangement taken thirty-seven hundred and fifty shares for their services, and had offered other stock to the public for subscription without disclosing this profit, were liable at the option of the corporation to return the shares, to turn over the entire profit made by them from selling the shares, or to pay to the corporation the amount which it had lost by not having the shares to sell.

In *Yale Gas Stove Co.* v. *Wilcox*, 64 Conn. 101, the

Court permitted recovery of the profit, the corporation not desiring to rescind the transaction.

In *Hayward* v. *Leeson*, 176 Mass. 310, the suit was maintained to recover profits, rescission being impossible.

In the case against Bigelow, identical with the present case, the Supreme Judicial Court of Massachusetts held that as alternative relief the profit was recoverable.

> *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315, 328, 329.

In *Franey* v. *Warner*, 96 Wis. 222, the Court, in describing the remedies in cases of the class under consideration, said:

> "Or without restoring, he, or all similarly interested joining, may sue in equity to charge such person as a trustee of the profits fraudulently retained by him and for an accounting." P. 235.

This statement was quoted with approval.

> *Hebgen* v. *Koeffler*, 97 Wis. 313, 320.

See also:

> *Burbank* v. *Dennis*, 101 Cal. 90.
> *The Telegraph* v. *Loetscher*, 127 Iowa, 383.
> *Parker* v. *Nickerson*, 112 Mass. 195.
> *South Joplin Land Co.* v. *Case*, 104 Mo. 572.
> *Woodbury Heights Land Co.* v. *Loudenslager*, 55 N. J. Eq. 78; 56 N. J. Eq. 411; 58 N. J. Eq. 556.
> *Spaulding* v. *North Mil. T. S. Co.*, 106 Wis. 481.

Counsel for the appellees argue strenuously that if rescission is for any reason impossible, there is no remedy except in cases where property is sold to a corporation by a person who, when he acquired it, was under a fiduciary obligation to acquire it for that corporation. To allow a recovery of profits made by a sale to the corporation under other circumstances would, it is said, be inadmissible, as amounting to enforcing a new contract at a lower price.

Reliance is placed upon the English cases as establishing a rule that without rescission there can be no recovery of a profit made by a sale in violation of fiduciary duty. Those cases do not establish any such rule.

In *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, recovery of profits was asked as alternative relief. Rescission of the contract was granted. In the House of Lords and in the lower courts the judges did, it is true, doubt the possibility of recovering profits, but the doubt was not necessary to the decision.

In *Re Ambrose Lake Mining Co.*, 14 Ch. D. 390, no recovery was possible because there had been no breach of fiduciary duty. The judges here also apparently doubted the propriety of allowing recovery of profits.

In *Re Cape Breton Co.*, 26 Ch. D. 221; 29 Ch. D. 795, it was held that when a promoter sold to a corporation property acquired by him before there was any duty on his part to the corporation, the sale might, if the facts warranted, be rescinded; but if rescission was not possible there could be no recovery. Lord Justice Bowen in the Court of Appeals dissented on the ground that the right to relief was not limited to rescission, but extended to recovery of whatever profit had been made by the breach of trust. In the House of Lords (*Cavendish Bentinck* v. *Fenn*, 12 App. Cas. 652) the decision below was affirmed on the ground that the acts were not sufficient to warrant relief on any theory.

In *Burland* v. *Earle*, (1902) App. Cas. 83, the Privy Council, in the case of a sale by an officer of a corporation, refused to allow a recovery of profits.

In *Lydney & Wigpool Iron Ore Co.* v. *Bird*, 33 Ch. D. 85, one who joined in promoting a corporation to purchase certain property and received a secret profit by way of commission paid from the purchase price was held liable to restore to the company the amount received, on the ground that it was a profit made by him by the use of his position.

In *Re Olympia, Limited*, (1898) 2 Ch. D. 153, the Court

of Appeals allowed recovery of profits, rescission being impossible. The Master of the Rolls (Lord Lindley) and Lord Justice Collins both pointed out that the House of Lords in the Cape Breton case had not approved the doctrine that rescission was the only remedy.

This decision was affirmed by the House of Lords in *Gluckstein* v. *Barnes*, (1900) A. C. 240, although there was no evidence of any duty on the part of the defendant to acquire the property for the corporation. Recovery of profits was held, in accordance with the dissenting opinion given by Lord Bowen in the Cape Breton Company case above mentioned, to be the appropriate relief where the profits were made by the violation of a fiduciary duty. The case cannot be distinguished on any ground of active misrepresentation or issue of a prospectus, because those facts, while important in fixing the rights of individual stockholders, are immaterial so far as rights of the corporation are concerned.

In *Re Leeds & Hanley Theatres*, (1902) 2 Ch. 809, the Court of Appeals again followed the view expressed by Lord Bowen. A promoting corporation was held accountable to the official liquidator for a profit made on a resale to a corporation promoted by it, which was being wound up. The Court expressly refused to consider whether the defendant was under any fiduciary duty at the time the property or a right to purchase it was acquired, but held that for a breach of its fiduciary duty existing subsequently the defendant was liable, and that the measure of recovery was the profit made by the promoters.

Any other rule than that applied in the case last cited and in the American cases leads to very unfortunate results. If rescission is impossible, although the impossibility results from no fault of the party wronged, recovery is barred. A promoter who has made an exorbitant profit solely by misuse of his position is permitted to retain the whole if he is fortunate or skilful enough to conceal the wrong until it is no longer possible to

rescind, but may be required to restore all if he is found out before rescission has become impossible.

By allowing recovery of profits as an alternative relief no injustice is done to the defendants. A trustee who in violation of his duty makes a secret profit by selling to his beneficiary is held liable because he has obtained the profit by the use of his position, just as he is held liable if he has taken a commission from one with whom he deals in behalf of the corporation.

Archer's Case, (1892) 1 Ch. D. 322.

A promoter is under no obligation to sell to the corporation. He may dispose of his property as he thinks fit; but if he disposes of it to the corporation the law says that he shall not do so in such a manner as to make a secret profit for himself. If, then, the promoter elects to sell to the corporation, he is bound so to conduct the transaction that he shall not make a secret profit, and if he violates this duty it is no injustice to compel him to give up the profit, to compel him to put the transaction on that basis on which alone he had a right to make it.

The adoption of such a rule does not give the corporation any right to play fast and loose. The Court can refuse an account of profits if rescission is practicable and a more just relief; and the corporation will lose the right to any relief by delay. On the other hand, to refuse any relief if rescission is impossible gives the wrongdoer the opportunity to gamble with impunity on the chance of the fraud remaining undiscovered until rescission is impracticable. If discovered in season the contract is rescinded and he loses nothing but his profit, retaking the property to do with it as he pleases; if not discovered in season he retains his profit. It requires a considerable degree of hardihood to contend that a wrongdoer is unjustly treated if upon the discovery of his wrongful act he is deprived of the profit that he has made instead of being given a second chance to make such a profit, especially when the only alternative is to permit him to retain the

profit. These considerations have led the American courts, practically without exception, to hold that an account of profits may be had as alternative relief, and led so distinguished a jurist as Lord Bowen to approve the same rule.

EIGHTH

ALBERT S. BIGELOW IS NOT A NECESSARY PARTY TO THIS SUIT.

I

If the relief sought can be granted without joining persons not within the jurisdiction, such persons need not be joined.

The general rule in equity is that all persons interested in the subject-matter of a suit should be joined as parties. In applying the rule, courts of equity recognize three classes of persons interested in the litigation: first, persons whose interest is such that they may properly be joined; second, persons whose interest is such that, if they are within the jurisdiction of the Court, they must be joined; third, persons whose interest is such that they must be parties to the suit or it cannot proceed.

Barney v. *Baltimore*, 6 Wall. 280.

Failure to join a person whose interest only makes him a proper party is of course not material. And since the requirements as to parties exist and are enforced for the purposes of justice, and not as a mere dogma,

Elmendorf v. *Taylor*, 10 Wheat. 152,

the courts will relax their requirements as far as possible, so as not to insist upon the presence as a party of a person who is interested in the suit, but cannot be brought in for want of jurisdiction over his person, or whose presence would oust the jurisdiction of the Court, if relief can be granted in his absence.

Payne v. *Hook*, 7 Wall. 425, 431.
Union Mill & M. Co. v. *Dangberg*, 81 F. R. 73, 90.
Mackay v. *Gabel*, 117 F. R. 873.

The distinction between persons who must be joined if possible and persons without the joinder of whom the suit cannot proceed is marked. As to the latter the Court said in *Wall* v. *Thomas*, 41 F. R. 620, 621:

"They are indispensable parties if their interest in the subject-matter of the suit, and the relief sought, are such that a final decree cannot be made without either affecting that interest, or leaving the controversy in such a condition that its final determination may be wholly inconsistent with equity and good conscience."

The distinction is based upon the power of the Court to make and enforce a proper decree. If the Court cannot make and enforce a decree against the persons who are before the Court without affecting the rights of others who are not before it, then the Court must require the absent parties to be brought in, and the impossibility of doing so does not remove the obstacle to the exercise of jurisdiction. But, if the bill establishes a case entitling the plaintiff to relief against a person who is before the Court, such relief can and should be granted, although there are other persons not before the Court who, to avoid multiplicity of suits or other inconveniences, ought to be joined as parties, if the plaintiff shows that he is unable to bring in those persons as parties because they are not within the jurisdiction of the Court.

Towle v. *Pierce*, 12 Met. 329, was a suit to recover a sum received by the defendant on a settlement of partnership accounts between himself, the plaintiff and two others. The plaintiff alleged that he had received less than his share, and the defendant more by the same amount. The court held that the other two partners, although obviously proper parties in a suit to settle partnership accounts, need not be joined, as they were without the jurisdiction.

II

The relief sought can be granted without affecting any rights of Bigelow, and without injury to the defendants.

1. Wherever relief is granted on a liability that is several, it is unnecessary to join persons who may also be jointly liable with the defendant.

At law joint tortfeasors may be sued separately.

Lovejoy v. *Murray*, 3 Wall. 1.
Luce v. *Dexter*, 135 Mass. 23.

The same principle applies in equity. The fact that other persons against whom, if they were joined, the same relief would be granted are not parties to the suit is no reason for not proceeding against those who are present.

Florence S. M. Co. v. *Grover & B. S. M. Co.*, 110 Mass. 1.

If several unite in a transaction that amounts to a breach of trust, it is no defence to a suit against one of them that the others are not joined. In *Palmer* v. *Stevens*, 100 Mass. 461, 466, the Court said:

"Certainly there can be no ground for contending that, if one of a number, who have jointly committed a fraud, is brought before a court of equity, relief against him is to be denied to the injured party because the others, equally guilty, cannot be made amenable to the process of the court."

Every proceeding seeking relief for a breach of trust or violation of fiduciary duty is based upon a several liability. Each person joining in such a breach of trust is liable *in solido*. The beneficiary may have satisfaction for the full amount which he is entitled to recover from any one of the wrongdoers, and consequently may proceed against any one without joining the rest.

In *Hazard* v. *Durant*, 19 F. R. 471, a suit was brought against trustees, seeking an account and the recovery of

trust funds. The Court held that the suit could be maintained although a part only of the guilty trustees were or could be joined.

A similar decision was rendered in *Trull* v. *Trull*, 13 Allen, 407.

Recovery against promoters, directors, and persons in similar fiduciary positions is upon the same footing. The basis for relief is the wrongful act, the violation of the fiduciary duty. Each of the persons joining in such violation is severally liable. If the relief sought is the recovery of profits, each may be held separately.

In *Hayward* v. *Leeson*, 176 Mass. 310, each of two promoters was sued separately, and a decree entered against each for the amount sought to be recovered. The Court did not limit the right to relief to an account of net profits; the ultimate decree was for the loss caused to the corporation. Nor did the Court base its right to relief on the issue of a prospectus, or on bulk of the money to purchase the property having been obtained by public subscriptions for stock.

In *Old Dominion Copper Mining and Smelting Co.* v. *Bigelow*, 188 Mass. 315, the Court held that "a suit founded on such an equitable tort" could be maintained against one of the two promoters jointly guilty.

In *Fountain Spring Park Co.* v. *Roberts*, 92 Wis. 345, it was held that persons associated with promoters in a plan by which a secret profit was taken upon a sale to the corporation were liable without regard to the amount that they actually received.

In *Woodbury Heights Land Co.* v. *Loudenslager*, 55 N. J. Eq. 78, a suit was maintained to recover profits from one of two promoters.

In *Gluckstein* v. *Barnes*, (1900) A. C. 240, one promoter was held liable for a sum received by him and three others as their share of the profits made by a syndicate which they formed to purchase property and sell it to a company. The other promoters were not before the Court. (1898) 2 Ch. 153.

See also:

Phosphate Sewage Co. v. *Hartmont*, 5 Ch. D. 394.
Bland's Case, (1893) 2 Ch. 612.

If in the present case the Court should grant relief by way of recovery of profits, Bigelow and the present defendants would each be liable for the full amount of the joint profit. No wrong could be done to either by permitting the plaintiff to establish this liability against one of them alone. There can, therefore, be no good reason for any absolute rule requiring both to be joined in one suit.

2. There is nothing peculiar to relief by rescission that prevents the application of this principle.

The relief granted by a court of equity in decreeing the rescission of a contract and the return of the consideration paid is founded on the same liability as a decree for recovery of profits. The decree recognizes the wrong done by the defendant and the consequent right of the plaintiff to avoid the contract, and, because he is entitled to and does avoid it, to recover what he has paid. At law a similar remedy is granted whenever a plaintiff has exercised a right to avoid a sale or other transaction by tendering a return of whatever of value he has received. The distinction is that at law the plaintiff proceeds on the basis of a completed rescission, while in equity he may proceed on the basis of a rescission not completed. In each case the purpose of the proceeding is to obtain restitution of what the plaintiff has paid.

Thomas v. *Beals*, 154 Mass. 51.

It has already been shown that all persons concerned in a transaction such as that now in question are severally as well as jointly liable for the entire amount recoverable by the plaintiff, and may be proceeded against severally as well as jointly. The only difference between a proceeding by which a rescission is decreed and one asking

for a recovery of profits is in the amount that may be recovered. The ground of liability is the same, and the several nature of the liability is the same. If the plaintiff can establish its right to rescission, it is entitled to recover the whole consideration paid by it from the present defendants alone, whether that recovery is in a proceeding to which Bigelow is a party or not. The decree in a suit founded on rescission runs against all who are defendants and are found liable, and may be satisfied by proceeding against any one of them, leaving him to such right of contribution as he may have. Such decrees were entered in

New Sombrero Phosphate Co. v. *Erlanger*, 5 Ch. D. 73, 125.
Lindsay Petroleum Co. v. *Hurd*, L. R. 5 P. C. 221, 231.

Where there are several defendants any one of whom may be required to make the entire repayment called for by the decree, it is obviously just that the decree should provide that the reconveyance by the plaintiff should be made to such one of the defendants as actually makes the repayment.

In *Lindsay Petroleum Co.* v. *Hurd*, L. R. 5 P. C. 221, such was the form of decree entered in the court below (see *Lindsay Petroleum Co.* v. *Hurd*, 16 Grant Ch. Rep. 147, 153), and approved by the Privy Council, the only change on the appeal being to provide for the possibility of the plaintiff corporation having been dissolved.

It appears, therefore, that if Bigelow were a party, the decree entered by the Court would order a repayment to the plaintiff for the whole of which the present defendants would still be liable severally with Bigelow, and for a reconveyance to whichever defendant made such repayment. The only difference between such a decree and the decree prayed for in this suit is that, if Bigelow were a party to this suit, his liability as well as that of the defendants would be established. The present suit asks to establish only the liability of the defendants. As that liability is in any event several, it is not necessary for its establishment that the liability of any other person should

be considered; and as the relief to be granted, so far as the defendants are concerned, and so far as Bigelow is concerned, is not affected in any way by the presence or absence of Bigelow as a party, he cannot be a necessary party.

The real test by which to determine whether or not a person is an indispensable party is whether a decree can be made without affecting that person's rights.

Chadbourne v. *Coe*, 51 F. R. 479.

Judged by this test, Bigelow is not a necessary party. No decree which the Court is asked to make will affect his rights. If the Court orders restitution by the defendants, and a conveyance by the plaintiff to the defendants, no rights of Bigelow are affected. All rights of the corporation against Bigelow will by satisfaction from the defendants be extinguished. If the defendants by satisfying the decree become entitled to a claim against him for contribution, they will be free to pursue their claim, and Bigelow will be no less free to dispute it. They received jointly the entire consideration paid by the plaintiff and as against the plaintiff at least each is liable for the whole.

For these reasons the Courts have never deemed it essential, in order to grant relief by rescission, that every one concerned in the transaction should be a party; they look only to the question whether the result can actually affect those not joined.

In *Ashmead* v. *Colby*, 26 Conn. 287, three individuals conspired to sell to a corporation a mine, practically worthless, title to which stood in the name of one of them. Subsequently a bill to rescind and recover the purchase money was brought. The individual by whom the conveyance was made died a non-resident before the suit was brought, and no personal representatives of him were made parties. The Court, however, granted the relief asked, on the ground that personal representatives of the deceased grantor were not indispensable parties, and that the objection of non-joinder had been waived.

A similar question was involved in *Donovan* v. *Campion*, 85 F. R. 71. The plaintiff there sought to recover property which he had been induced to convey to one Budd, who, it was alleged, was a mere conduit to pass title to the defendant. It was held that Budd, although the person to whom the conveyance was actually made, was not a necessary party.

In *Anthony* v. *Campbell*, 112 F. R. 212, the Boston Safe Deposit and Trust Company, as trustee under a mortgage of certain securities, sold the securities at the instigation of a majority of bondholders to further a plan of reorganization. The Court held that, having before it the purchaser of the securities and the company for whose benefit the sale had been made, it could set aside the sale without the Trust Company being joined as a party, protecting the latter from any effect upon its rights by proper reservation in the decree.

See also:

Gross v. *G. W. Scott Mfg. Co.*, 48 F. R. 35.
Smith v. *Lee*, 77 F. R. 779.

In the present case the plaintiff is entitled to full relief against the defendants. It might prove that for some reason Bigelow was not liable or that he was not able to make restitution. The defendants would, in that event, none the less be bound to make restitution of the full consideration paid by the plaintiff. If in some future proceeding between the defendants and Bigelow the latter should defeat a claim for contribution, the defendants would have suffered nothing, as they could have paid only what would have been recoverable from them if Bigelow had been a party to this suit. And Bigelow will suffer nothing from the decree of the Court in this suit because as against him it will establish nothing.

The only practical ground for saying that Bigelow is a necessary party is the possibility that otherwise perchance the whole liability may be enforced against the present defendants. But a court will never refuse relief

against a wrongdoer because it cannot in the same proceeding establish rights of contribution between several wrongdoers.

This objection to relief has frequently been raised and always been dismissed. In *Gluckstein* v. *Barnes*, (1900) A. C. 240, the Court was asked to direct proceedings against others of the promoters before requiring the defendant to make good the amount recovered against him (consisting of the profits of four out of a greater number of promoters). Lord Macnaghten said:

> "He may or may not be able to recover a contribution from those who joined with him in defrauding the company. He can bring an action at law if he likes. If he hesitates to take that course or takes it and fails, then his only remedy lies in an appeal to that sense of honor which is popularly supposed to exist among robbers of a humbler type." P. 255.

Counsel for the defendants has argued that because there was a joint interest in the sale made by Lewisohn and Bigelow therefore Bigelow must be a party to a rescission. There can be no technical necessity because the contract of sale was in fact made with Lewisohn alone, whatever Bigelow's interest in it may have been.

No case has been cited for the appellees establishing any such absolute rule as to joinder. All of the cases referred to are cases in which the decree would necessarily and actually affect the interests of the persons not before the Court.

In *Shields* v. *Barrow*, 17 How. 130, property was sold and notes given for part of the price, on which six persons were indorsers. A compromise was subsequently made by which certain payments were to be made by the indorsers and all liabilities on the original sale and notes cancelled. The bill was brought against two of the indorsers, the purchaser and the other four indorsers being non-residents, to set aside the compromise and compel payment by the defendants of such of the original notes as fell due. The Court held that there was a fatal lack

of parties. Obviously a rescission of the compromise decreed in the absence of the maker of the original notes could not restore to the indorsers their right of recovery against the maker in case of payment. This consideration alone is enough to show that there was a real absence of necessary parties.

In *Coiron* v. *Millaudon*, 19 How. 113, the mortgagees were held necessary parties to a suit to set aside a foreclosure sale, on the ground that if the sale was set aside they would be liable to refund to the purchaser what they had received.

In *Barney* v. *Baltimore*, 6 Wall. 280, it was held that a partition suit could not be maintained in the absence of one of the joint owners.

Bank v. *Carrollton Railroad*, 11 Wall. 624, was a suit by the assignee of one of three partners to recover a share of the partnership property. The Court held the partners must be joined, as there would have to be an account.

In *Ribon* v. *Railroad Co.*, 16 Wall. 446, it was held that persons who received the proceeds of a foreclosure sale were necessary parties to a suit to set it aside, as they would become liable to refund what they had received.

Williams v. *Bankhead*, 19 Wall. 563, was a bill to recover a specific fund claimed by one who was not joined as a defendant.

In *Bell* v. *Donohoe*, 17 F. R. 710, a stockholder sued in the right of a corporation, not joined, to set aside a transaction between the corporation and two partners, of whom one only was joined. The Court held the corporation and the other partner necessary parties. Obviously the suit was not maintainable in any event without the corporation.

In *Duchess D'Auxy* v. *Porter*, 41 F. R. 68, it was held that to a bill by the executor of a deceased partner for an accounting all the surviving partners were necessary parties.

In *Wall* v. *Thomas*, 41 F. R. 620, the Court refused to enjoin part of a board of trustees from doing acts alleged

to be in breach of trust, because by so doing it would in effect prevent the absent trustees from acting without their having an opportunity to be heard, and might also expose the trustees restrained to proceedings for refusing to join in doing the acts.

In *Chadbourn* v. *Coe*, 45 F. R. 822, it was held that a creditor could not maintain a suit to recover and apply to the satisfaction of his claim, not reduced to judgment, property alleged to have been fraudulently conveyed by his debtor without joining the debtor.

In all of these cases it will be seen that there was a practical objection to the maintenance of the suit in that either the necessary result of a decree would be to create a liability, or produce a situation in which a liability should exist, against absent persons, or the decree would give to a person property claimed by one not a party, or in which one not a party had an adverse interest, or that accounts must be taken affecting the rights of the absent person, or in some similar way the rights of one not a party would necessarily and practically be affected.

No case has been cited in which a suit to rescind a sale or recover profits made by a sale from persons in a fiduciary relation has failed because one or more of those persons could not be joined, or in which an objection of want of parties has in such a case been considered.

In the report of *New Sombrero Phosphate Co.* v. *Erlanger*, 5 Ch. D. 73, 83, it is stated that the defendants' answer submitted that all members of the syndicate should be joined, and that they were accordingly added by amendment, but whether by direction of the Court does not appear. No question as to parties was considered in any of the opinions in any of the courts.

In the present case it has been shown that there is no practical reason why relief cannot justly be given in the absence of Bigelow, just as the Supreme Judicial Court of Massachusetts has held that in the suit there relief can be given against Bigelow in the absence of the present defendants. That decision does not limit the relief to a

recovery of profits. On the contrary, the Court expressly stated that "if the defendant does in fact restore the whole consideration, he will be subrogated to the real estate here in question." 188 Mass. 329.

NINTH

THE BILL IS NOT MULTIFARIOUS.

I

The bill does not join different and inconsistent cases.

The only case set forth in the bill as to which relief is asked is the sale of certain real estate to the plaintiff for the benefit of the defendants' testator and his associate, Bigelow. As to this sale, the plaintiff seeks a rescission or other appropriate relief. The fact that the bill sets forth matters as to connected transactions which might form a ground for relief, and do form the ground for relief asked in another suit, cannot make the present bill multifarious.

See *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315.

If under any circumstances such statements could be deemed to afford a basis for relief under the general prayer, and to make the bill multifarious, the express disclaimer in paragraph twenty-sixth of the amended bill obviates any such difficulty.

II

The bill does not ask for different reliefs inconsistent with each other.

The appellees not having appealed from the decree overruling the demurrer based on alleged multifariousness, cannot now rely on that ground.

Landam v. *Jordan*, 203 U. S. 56.

Assuming the objection still to be open it is not well founded.

A plaintiff may always file a bill asking for such relief in the alternative as the Court may determine is appropriate to the facts alleged. He cannot set up inconsistent states of facts and ask for relief according as the one or the other is established, but having stated his case, he may put his prayer in the alternative if in doubt as to the relief to which on the facts he is entitled. Such an alternative prayer does not render the bill multifarious.

Kilgour v. *N. O. Gas Light Co.*, 2 Woods, 144.
Bagot v. *Easton*, 7 Ch. D. 1.
Foulkes v. *Davies*, L. R. 7 Eq. 42.
Stein v. *Robertson*, 30 Ala. 286.

In *Bagot* v. *Easton*, 7 Ch. D. 1, the bill alleged that the plaintiff was induced by the defendant's fraud to enter into a partnership and contribute twenty-four hundred pounds. He prayed for a rescission, and in the alternative, on additional facts alleged as to the defendant's conduct, recovery of the twenty-four hundred pounds or for a dissolution. The Court held that the case was a suitable one to ask alternative relief; that there was no inconsistency in asking such relief; and that it was not a joining of two causes of action.

The relief asked in the present suit is a rescission of the sale and an accounting for the consideration received, or, in the alternative, that the defendant pay the plaintiff the loss suffered by the plaintiff through the wrongful disposition of these shares.

These prayers are entirely consistent. *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315. Each rests upon the same state of facts, — the violation by the defendant of his duty to the plaintiff, and the consequent damage suffered. Each affirms the wrongfulness of the acts set forth. The only undetermined point is whether the proper relief for these wrongful acts is by a rescission or by a recovery of damages. A prayer for

alternative relief is only inconsistent when granting one alternative involves denying the facts on which the other alternative is founded. Thus a bill alleging that a will is invalid and asking relief as heir-at-law, and joining an alternative prayer that, if the will be valid, the executor be removed, is bad for asking inconsistent relief.

Colton v. *Ross*, 2 Paige, 396.

The principle as to alternative relief was stated by Vice-Chancellor Page-Wood to be:

"You have no right to allege two inconsistent states of facts and ask relief in the alternative, for the two cannot be true; but you have always a right to state the facts of the case, the documents and deeds, and ask the conclusion of the Court on those facts and documents, and say the Court may come to one conclusion of law or it may come to another; and you may ask the Court to come to a conclusion on the facts which you have disclosed, having stated everything that will enable the Court to form a proper judgment. You may ask the judgment of the Court on two alternatives. That may be done on any bill without objection."

Rawlings v. *Lambert*, 1 Johns. & H. 458, 466.

In the present case, to grant either alternative form of relief asked, the Court must find the same facts.

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